# Ethical Pitfalls for Florida Practitioners
# Under the Foreign Corrupt Practices Act

Nina B. Finston
Branch Chief, Division of Enforcement
U.S. Securities and Exchange Commission
Washington, D.C.

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# INTRODUCTION

Recent corporate scandals, such as Enron and Worldcom, inevitably give rise to the question of where were the "gatekeepers"—boards of directors, audit committees, outside auditors and corporate counsel. This heightened scrutiny has resulted in significant changes affecting the respective roles and obligations of each. A key change relates to the obligations of counsel on detecting possible illicit conduct. The Sarbanes-Oxley Act of 2002, and regulations implemented by the Securities and Exchange Commission ("SEC") in August 2003, require attorneys appearing or practicing before the SEC to report "up the ladder" within their clients or organizations evidence of a material violation of the securities laws, material breach of fiduciary duty or other similar material violation, and also permit counsel to disclose the violative conduct to the SEC in certain circumstances. Also in August 2003, the ABA's House of Delegates amended Model Rules of Professional Conduct 1.6 and 1.13 to authorize disclosures by counsel of fraudulent or criminal conduct both within the organizations they represent, and to persons outside in limited circumstances. Amendments to the Florida Rules of Professional Conduct are currently being considered.

While corporate scandals of the past few years prompted these changes, another wave of corporate scandals in the 1970s resulted in the enactment of the Foreign Corrupt Practices Act ("FCPA"). The FCPA created the books-and-records and internal-controls provisions of the federal securities laws, which have been so effectively used in accounting fraud cases. Additionally, the FCPA made illegal the payment of bribes to foreign officials for the purpose of obtaining or retaining business.

The following sets forth the FCPA's books-and-records, internal-controls and anti-bribery provisions and discusses: (1) the SEC's enforcement activities in general, including an explanation of how enforcement by the Department of Justice ("DOJ") compares and contrasts with the SEC's; (2) recent examples of the SEC's enforcement of the FCPA's provisions; (3) counsel's response to uncovering or detecting an FCPA violation consistent with the requirements of the Sarbanes-Oxley Act, the SEC's rules, and, to the extent they are not in conflict, the Florida Rules of Professional Conduct.

## I. THE FCPA

### A. Background

The Watergate episode brought to light that U.S. issuers were paying bribes to foreign officials to obtain business. Further inquiries by the SEC revealed that over 300 U.S. issuers had, among other things, created "slush funds" to pay bribes. In response, Congress enacted the FCPA in 1977. The FCPA sought to eliminate this conduct by: (1) imposing a requirement that public companies maintain accurate books and records for financial reporting purposes and implement internal controls to ensure accurate financial reporting; and (2) prohibiting illicit payments to foreign

officials. These provisions are set forth in Sections 13(b)(2)(A), 13(b)(2)(B) and 30A of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78a *et seq*.].

B. The FCPA's Provisions

1. The FCPA's Books-and-Records and Internal Controls Provisions.

a. Exchange Act Section 13(b)(2)(A) [15 U.S.C. § 78m(b)(2)(A)] requires that issuers "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."

b. Exchange Act Section 13(b)(2)(B) [15 U.S.C. § 78m(b)(2)(B)] requires that issuers "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that" (1) transactions are executed in accordance with management's authorization; (2) transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP or other criteria and to maintain accountability for assets; (3) access to assets is permitted in accordance with management's authorization; and (4) assets are compared to those recorded on the books and records at regular intervals and any differences addressed.

2. The FCPA's Anti-Bribery Provisions.

a. Exchange Act Section 30A [15 U.S.C. § 78dd-1] makes it unlawful:

(1) for any issuer which has a class of securities registered under Exchange Act Section 12 or which is required to file reports under Exchange Act Section 15(d), or officer, director, employee or agent of such issuer who is acting on behalf of such issuer,

(2) to make use of the mails or any means or instrumentality of interstate commerce

(3) corruptly

(4) in furtherance of an offer, payment, promise to pay, or authorization of the payment of anything of value to

(5) a foreign official, foreign political party or official thereof or candidate for foreign political office or any other person while knowing that all or a portion of such thing of value will be offered, given, or promised, directly or indirectly, to a foreign official, foreign political party or official thereof or candidate for foreign political office

(6) for purposes of:

(a) influencing any act or decision of such party, official, or candidate in its or his official capacity,

(b) inducing such party, official, or candidate to do or omit to do an act in violation of the lawful duty of such party, official, or candidate,

(c) securing any improper advantage; or

(d) inducing such party, official or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality

(7) in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

(8) As amended in 1998, the FCPA anti-bribery provisions also grant the SEC jurisdiction over acts committed outside the United States by United States entities or persons in furtherance of making an illicit payment without regard to whether the mails or any means or instrumentality of interstate commerce is employed. This provision applies to issuers incorporated under the laws of the United States or a state, territory, or other political subdivision of the United States, and to certain associated persons who are United States nationals

or organized under the laws of the foregoing jurisdictions.

b. "Grease" payments excepted. The prohibition does not extend to "facilitating or expediting payments" which are made for the purpose of expediting or securing the performance of routine governmental action.

c. Affirmative defenses. It is an affirmative defense that the payment, gift, offer or promise of anything of value was:

(1) lawful under the written laws and regulations of the foreign country, or

(2) a reasonable and bona fide expenditure and was directly related to the promotion, demonstration or explanation of products or services or the execution or performance of a contract with a foreign government.

## II. SEC INVESTIGATIONS AND ENFORCEMENT ACTIONS

### A. SEC investigations

#### 1. General observations

a. It has long been standard practice in every financial fraud investigation for the SEC to evaluate the accuracy of an issuer's financial reporting and books and records and the adequacy of its internal controls. When there is evidence of illicit payments to foreign officials, the SEC fully investigates whether there is a violation of the anti-bribery, reporting and accounting provisions.

b. Investigations relating to events and parties in other countries obviously present difficulties, particularly when dealing with a foreign issuer. The SEC has negotiated Memoranda of Understanding with 31 foreign governments which will better enable the SEC to obtain information. Additionally, foreign countries have adopted statutes which empower authorities in those countries to assist the SEC.

2. Differences between SEC and DOJ investigations

a. The SEC's jurisdiction under the FCPA extends to public companies and their officers, directors, employees and agents. DOJ's jurisdiction overlaps with the SEC's and extends to all other "domestic concerns," including private companies, covered by the FCPA.

b. DOJ FCPA investigations generally appear in practice to focus on violations of the anti-bribery provision. SEC investigations are generally broader, focusing on violations of the anti-bribery, books-and-records and internal-controls provisions.

c. The SEC is authorized to bring civil actions, although it can and does make criminal referrals. The DOJ is authorized to bring criminal and civil actions. The obvious difference between civil and criminal actions is the standard of proof. The SEC need only prove its case by a preponderance of the evidence, not beyond a reasonable doubt as is required in criminal proceedings. In cases where the SEC and the DOJ conduct parallel investigations of the same matter, the SEC often benefits indirectly by access to criminal proffers conducted by the DOJ.

B. SEC Enforcement Actions[1]

1. General Lessons to be Learned from SEC actions. The SEC has brought many actions in recent years arising out of the making of illicit payments. These, and two earlier civil actions brought by the SEC--*SEC v. Triton Energy Corporation, et al.*, 1:97CV00401 (D.D.C. February 27, 1997) and *SEC v. Montedison, S.p.A.*, 1:96CV02631 (D.D.C. November 21, 1996)--show that there are certain red flags to which companies, and their senior management and directors in particular, should be sensitive, including:

a. operating in a country that is high-risk for bribery;

b. operating in an industry that is high-risk for bribery;

c. operating a joint venture with a foreign government entity;

[1] Copies of SEC litigation releases, administrative orders and complaints may be accessed at www.sec.gov.

d. entering into consulting and agency arrangements with persons acting as intermediaries with the foreign government;

e. employing as intermediaries persons who also have control over financial expenditures of or financial reporting by the foreign venture;

f. payments to foreign agents which are unusual given prevailing rates in the local economy and the nature of services provided; and

g. making bonuses for employees in foreign operations contingent on reaching unduly aggressive operating results, particularly when their ability to make such targets is within the discretion or control of a foreign authority.

2. *In the Matter of BJ Services Company*, Admin. Proc. File No. 3-11427 (Sec. Ex. Act Rel. No. 49390/AAER No. 1972/March 10, 2004): On March 10, 2004, the SEC entered a settled cease-and-desist order against BJ Services Company ("BJS") for violations of the FCPA's anti-bribery, books-and-records and internal control provisions stemming, in part, from illicit payments made through its Argentinean subsidiary to customs officials. In one instance, an Argentinean customs official demanded a bribe for the release of equipment that had been imported into the country in violation of Argentinean customs law. Payment of the bribe ensured avoidance of fines and charges relating to re-importation of the equipment, and also avoided any disruption to business. On a subsequent occasion, bribes were paid to an Argentinean customs official to overlook a prior customs violation and not fine the company. These payments were improperly characterized on the company's books and records. BJS consented to cease and desist from further violations.

3. *SEC v. Syncor International Corporation*, Case No. 1:02CV02421 (D.D.C.) (Lit. Rel. No. 17887/AAER No. 1688 (December 10, 2002); In the Matter of Syncor International Corporation, Admin. Proc. File No. 3-10969 (Sec. Ex. Act Rel. No. 46979/AAER No. 1687/December 10, 2002): On December 10, 2002, the SEC entered a settled cease-and-desist order and filed a settled civil penalty action in federal district court charging Syncor International Corporation, a radiopharmaceutical company based in Woodland Hills, California, with violating the FCPA. The SEC charged that, from at least the mid-1980s through at least September 2002, Syncor's foreign subsidiaries in Taiwan, Mexico,

Belgium, Luxembourg, and France made a total of at least $600,000 in illicit payments to doctors employed by hospitals controlled by foreign authorities. According to the SEC, these illicit payments were made with the purpose and effect of influencing the doctors' decisions so that Syncor could obtain or retain business with them and the hospitals that employed them. The SEC charged, moreover, that the payments were made with the knowledge and approval of senior officers of the relevant Syncor subsidiaries, and in some cases with the knowledge and approval of Syncor's founder and chairman of the board. Without admitting or denying the Commission's charges, Syncor consented to the entry of a final judgment in the federal lawsuit requiring it to pay a $500,000 civil penalty and consented to the Commission's issuance of a cease-and-desist order in which it undertook to retain an independent consultant to review and make recommendations concerning the company's FCPA compliance policies and procedures. In determining to accept Syncor's settlement offer, the SEC considered the full cooperation that Syncor provided to the SEC staff during its investigation. The SEC also considered the fact that Syncor -- after being alerted to the relevant conduct by another company that was conducting due diligence relating to a previously announced merger with Syncor -- promptly brought this matter to the attention of the SEC's staff and the U.S. Department of Justice. The DOJ instituted a settled criminal proceeding in which Syncor plead guilty to having violated the anti-bribery provisions, and paid a $2 million fine.

4. *SEC v. Douglas A. Murphy, et al.*, Civil Action No. H-02-2908 (S.D. Tex.) (Lit. Rel. No. 17651/AAER Rel. No. 1607/August 1, 2002); *United States v. David Kay, et al.*, 200 F. Supp. 2d 681 (S.D. Tex. April 18, 2002), *appeal docketed*, No. 02-20588 (5th Cir. May 28, 2002); *In the Matter of American Rice, Inc., Joseph A. Schwartz, Jr., Joel R. Malebranche and Allen W. Sturdivant*, Admin. Proc. File No. 3-11024 (Sec. Ex. Act Rel. 47286/AAER No. 1710/January 30, 2003)

On July 30, 2002, the SEC filed a civil injunctive action in federal district court against two former officers of American Rice, Inc. ("ARI"), a Houston, Texas-based company, Douglas A. Murphy and David G. Kay, as well as Lawrence H. Theriot, a former ARI consultant, in connection with bribery payments to Haitian customs officials in violation of the FCPA. *SEC v. Murphy*, Civil Action No. H-02-2908 (S.D. Tex.) (Lit. Rel. No. 17651/AAER Rel. No. 1607/August 1, 2002) According to the complaint, Kay, formerly vice-president of ARI, authorized the payment of bribes to officials of the Republic of Haiti to obtain their agreement to

accept false bills of lading that understated the amounts of rice being imported into Haiti, thus reducing the amount of duties and taxes to be paid by ARI. In order to conceal the payments, Kay directed that the payments be recorded as ordinary business expenses. Murphy, formerly ARI's president, allegedly was aware of or knowingly disregarded these payments. Murphy also allegedly authorized the payment of at least one bribe relating to the filing of information with Haitian tax officials which reflected lower than actual rice sales. The complaint alleges that they authorized over $500,000 in bribery payments to Haitian customs officials during 1998 and 1999 in order to reduce ARI's import taxes by $1.5 million. According to the complaint, Theriot aided and abetted these violations.

In parallel criminal proceedings, the Department of Justice obtained twelve-count indictments charging Murphy and Kay with criminal violations of the FCPA. *United States v. Kay*, 200 F. Supp. 2d 681 (S.D. Tex. April 18, 2002), *appeal docketed*, No. 02-20588 (5th Cir. May 28, 2002) On April 16, 2002, the U.S. District Court for the Southern District of Texas dismissed the indictments, holding, in a matter of first impression, that the bribes were not paid for the purpose of "obtaining or retaining business," as required by the text of the FCPA, since their purpose was merely to obtain favorable tax treatment. The court reasoned that the statutory text was ambiguous on its face, but that the legislative history of the statute, as originally enacted and later amended, reflected decisions by Congress not to expand the language of the FCPA to proscribe bribes paid to obtain favorable tax treatment. On May 28, 2002, the DOJ appealed the dismissal to the U.S. Court of Appeals for the Fifth Circuit.

On September 11, 2002, the SEC joined in the DOJ's appeal by filing a brief as *amicus curiae* urging the U.S. Court of Appeals for the Fifth Circuit to reverse the dismissal. In their briefs on appeal, both the DOJ and the SEC challenged the district court's reading of the statutory text as well as its interpretation of the legislative history. On February 4, 2004, the Court issued its decision reversing the lower court's dismissal and remanding for further proceedings. The appellate court held that the FCPA applies "broadly to payments intended to assist the payor, either directly or indirectly, in obtaining or retaining business," and that "bribes paid to foreign tax officials to secure illegally reduced customs and tax liability constitute a type of payment that can fall within this broad coverage," provided that a business-purpose nexus can be established. *U.S. v. Kay, et al.*, 359 F.3d 738 (5$^{th}$ Cir. 2004).

On January 30, 2003, the SEC entered a settled cease-and-desist order against ARI, two former ARI employees involved in rice shipments to Haiti, Joel R. Malebranche and Allen W. Sturdivant, and a former ARI controller in Haiti, Joseph A. Schwartz, Jr. The SEC found that ARI paid bribes with regard to at least twelve shipments of rice into Haiti. These payments were made with the knowledge and at the direction of Kay. In general, Malebranche negotiated each bribe, Schwartz issue checks drawn on ARI's bank account and falsely recorded the amounts as routine business expenditures on ARI's books and records, and Sturdivant falsified the shipping records with respect to each shipment. The SEC further found that ARI lacked internal controls that were reasonably designed to prevent or detect FCPA violations. Each of the respondents consented to cease and desist from further violations. *In the Matter of American Rice, Inc., Joseph A. Schwartz, Jr., Joel R. Malebranche and Allen W. Sturdivant*, Admin. Proc. File No. 3-11024 (Sec. Ex. Act Rel. 47286/AAER No. 1710/January 30, 2003)

5. *SEC v. Eric L. Mattson, et al.*, Civ. No. H-01-3106 (S.D. Tex.) Lit. Rel. No. 17126/AAER No. 1445/September 12, 2001), *compl. amended* (S.D. Tex. September 20, 2002); *United States and SEC v. KPMG Siddharta Siddharta & Harsono, et al*., Civ. No. H-01-3105 (S.D. Tex.) (Lit. Rel. No. 17127/AAER Rel. No. 1446/September 12, 2001); *In the Matter of Baker Hughes Incorporated*, Admin. Proc. File No. 3-10572 (Sec. Ex. Act. Rel. No. 44784/AAER Rel. No. 1447/September 12, 2001)

On the basis of the *Kay* court's ruling that payments to foreign officials to obtain more favorable tax treatment do not violate the anti-bribery provisions of the FCPA, the same district court dismissed the SEC's anti-bribery claim against two defendants in a separate pending civil action relating to payments made by Baker Hughes. By way of background, the SEC's complaint filed in 2001 alleged that Eric Mattson, the former CFO of Baker Hughes, a NYSE-listed company, and James W. Harris, Baker Hughes' former controller, authorized the payment of a $75,000 bribe, through KPMG-Siddharta Siddharta & Harsono ("KPMG-SSH"), Baker Hughes' agent and accountant in Indonesia, to a local tax official in Indonesia. The purpose of the bribe was to induce the official to reduce a tax assessment by the Indonesian government from $3.2 million to $270,000 for Baker Hughes' beneficially owned Indonesian company. The bribe was disguised as a legitimate payment through a false KPMG-SSH invoice that overstated the amount due for professional services rendered. Following the district court's ruling in *Kay* and subsequent

dismissal of the anti-bribery claims against Mattson and Harris in this action, the SEC amended its complaint to state with greater specificity the remaining books-and-records and internal controls claims against the two defendants. *See SEC v. Eric L. Mattson, et al.*, Civ. No. H-01-3106 (S.D. Tex.) (Lit. Rel. No. 17126/AAER No. 1445/September 12, 2001), *compl. amended* (S.D. Tex. September 20, 2002) These claims were dismissed upon subsequent motion of the SEC.

Following the *Kay* decision in February 2004, the SEC moved for summary reversal of the order dismissing the SEC's Section 30A claim and for remand. The motion was denied. The SEC's merit brief, as appellant, is currently due to be filed on July 19, 2004.

Independent of the action against Mattson and Harris, on September 11, 2001, the SEC and the Department of Justice jointly filed, for the first time ever, a civil injunctive action. *See United States and SEC v. KPMG Siddharta Siddharta & Harsono, et al.*, Civ. No. H-01-3105 (S.D. Tex.) (Lit. Rel. No. 17127/AAER Rel. No. 1446/September 12, 2001) The action was filed against KPMG-SSH and its partner, Sonny Harsono, for their involvement in making the illicit payment. Harsono allegedly advised KPMG-SSH personnel that KPMG-SSH would be willing to pay the Indonesian tax official if instructed to do so directly by Baker Hughes. To conceal the improper payment, Harsono agreed with KPMG-SSH personnel that KPMH-SSH should generate a false invoice that would cover the payment to the Indonesian tax official and KPMG-SSH's fees for services rendered. Without admitting or denying the allegations of the complaint, KPMG-SSH and Harsono consented to the entry of a final judgment that permanently enjoins both defendants from violating and aiding and abetting the violation of the FCPA's anti-bribery, books-and-records and internal-controls provisions.

The SEC also entered a settled cease-and-desist order on September 12, 2001, against Baker Hughes for violations of the books-and-records and internal-controls provisions arising from the payment to the Indonesian tax official, as well as payments authorized by senior managers of Baker Hughes in 1995 and 1998 to agents in Brazil and India, respectively, without adequately inquiring whether the payments might be made to foreign government officials in violation of the FCPA. Without admitting or denying the SEC's findings, Baker Hughes consented to entry of an order requiring it to cease and desist from committing or causing any violation of the books-and-records and internal-controls provisions. *See In the Matter of Baker Hughes*

*Incorporated*, Admin. Proc. File No. 3-10572 (Sec. Ex. Act. Rel. No. 44784/AAER Rel. No. 1447/September 12, 2001)

6. *SEC v. BellSouth Corporation*, Civil Action No. 1:02-CV-0113 (N.D. Ga.) (Lit. Rel. No. 17310/AAER Rel. No. 1495/Jan. 15, 2002); *In the Matter of BellSouth Corporation*, Admin. Proc. File No. 3-10678 (Sec. Ex. Act Rel. No. 45279/AAER Rel. No. 1494/Jan. 15, 2002)

On January 15, 2002, the SEC filed a settled civil action in federal court in which BellSouth Corporation consented to a judgment, without either admitting or denying the SEC's allegations. *SEC v. BellSouth Corporation*, Civil Action No. 1:02-CV-0113 (N.D. Ga.) (Lit. Rel. No. 17310/AAER Rel. 1495/Jan. 15, 2002) The judgment directed it to pay a $150,000 civil penalty. The SEC's complaint alleges that BellSouth violated the books-and-records and the internal-controls provisions of the FCPA in connection with payments made by its Venezuelan and Nicaraguan subsidiaries.

According to the complaint, between September 1997 and August 2000, the former management of BellSouth's Venezuelan subsidiary, Telcel, C.A., authorized payments totaling $10.8 million to six offshore companies. Based on fictitious invoices, the payments were improperly recorded in Telcel's books and records as bona fide services. Telcel's internal controls failed to detect these payments for at least two years. The complaint also alleges that, beginning in October 1998 and ending with a severance payment in June 1999, BellSouth's Nicaraguan subsidiary, Telfonia Celular de Nicaragua, S.A., improperly recorded payments to the wife of the chairman of Nicaragua's telecommunications legislative committee, in exchange for her successful efforts to repeal a Nicaraguan law that prohibited foreign companies like BellSouth from acquiring a majority interest in Nicaraguan telecommunications companies like Telefonia. The payments were falsely reported as consulting fees.

Also on January 15, 2002, in a related proceeding, the SEC issued a settled cease-and-desist order against BellSouth in which the SEC found, based on the same underlying facts, that BellSouth violated the books-and-records and internal control provisions of the Exchange Act. *In the Matter of BellSouth Corporation*, Admin. Proc. File No. 3-10678 (Sec. Ex. Act Rel. No. 45279/AAER Rel. No. 1494/Jan. 15, 2002) BellSouth consented to entry of the order without admitting or denying the SEC's findings.

7. *In the Matter of Chiquita Brands International, Inc.*, Admin. Proc. File No. 3-10613 (Sec. Ex. Act Rel. No. 44902/AAER Rel. No. 1463/October 3, 2001); *SEC v. Chiquita Brands International, Inc.*, 01 CV 02079 (D.D.C.) (Lit. Rel. No. 17169/AAER Rel. No. 1464/October 3, 2001)

   On October 3, 2001, the SEC entered a settled cease-and-desist order and filed a settled civil action in federal district court arising out of a payment to foreign customs officials by a wholly-owned foreign subsidiary of Chiquita Brands International, Inc. According to the administrative order, without the knowledge or consent of any Chiquita employees outside Colombia and in contravention of Chiquita's policies, employees of the wholly-owned subsidiary, C.I. Bananos de Exportacion S.A. ("Banadex"), authorized a payment in pesos equaling approximately $30,000 to local customs officials to overlook two prior citations for customs violations in renewing Banadex's license to hold goods for customs inspection at Banadex's Turbo, Colombia port facility. Banadex made the payment in two installments in 1996 and 1997, which it incorrectly identified on its books and records. Chiquita's internal auditing staff became aware in 1996 of several instances in which Banadex failed to properly document payments made during that year. On discovering the 1996 installment payment in 1997, Chiquita conducted an internal investigation and took corrective action, including terminating the responsible Banadex employees and reinforcing internal controls at Banadex. Without admitting or denying the SEC's findings, Chiquita consented to the entry of an order requiring it to cease and desist from violations of the books-and-records and internal-control provisions of Exchange Act Sections 13(b)(2)(A) and (B). Without admitting or denying the allegations of the complaint, Chiquita agreed to pay a $100,000 civil penalty in the settled civil action.

8. *In the Matter of American Bank Note Holographics, Inc.*, Admin. Proc. No. 3-10532 (Sec. Act Rel. No. 7994/Sec. Ex. Act. Rel. No. 44563/AAER Rel. No. 1422/July 18, 2001); *SEC v. American Bank Note Holographics, Inc.*, 01 CV 6453 (S.D.N.Y.) (Lit. Rel. No. 17068A/AAER Rel. No. 1425A/July 18, 2001); *SEC v. Morris Weissman, et al.*, 01 CV 6449 (S.D.N.Y.) (Lit. Rel. No. 17068A/AAER Rel. No. 1425A/July 18, 2001)

   On July 18, 2001, the SEC entered a settled cease-and-desist order arising in part from American Bank Note Holographics, Inc.'s ("ABNH") violation of the FCPA's anti-bribery provisions. *In the Matter of American Bank Note Holographics, Inc.*, Admin. Proc.

No. 3-10532 (Sec. Act Rel. No. 7994/Sec. Ex. Act. Rel. No. 44563/AAER Rel. No. 1422/July 18, 2001) ABNH employed agents to seek out business in various regions in the world. One agent informed an ABNH employee in 1998 of an opportunity to bid on a contract to produce holograms for the Saudi Arabian government. To secure the contract, ABNH's then chairman and CEO Morris Weissman and then executive vice president and general manager Joshua Cantor, authorized and directed an ABNH employee to wire $239,000 to a Swiss bank account for the benefit of one or more Saudi Arabian officials. ABNH recorded this payment as a consulting fee. After the company's auditors detected the questionable transactions in late 1998, the company conducted an internal investigation and took remedial action, including terminating certain of the people involved and apprising the staff of its findings. Without admitting or denying the SEC's findings, ABNH consented to cease and desist from violating or causing the violation of the FCPA's anti-bribery provisions, books-and-records and internal-controls provisions. In connection with this settlement, the SEC filed a civil penalty proceeding and ABNH, without admitting or denying the complaint's allegations, consented to pay a $75,000 civil penalty for its violation of the FCPA's anti-bribery provisions. *See SEC v. American Bank Note Holographics, Inc.*, 01 CV 6453 (S.D.N.Y.) (Lit. Rel. No. 17068A/AAER Rel. No. 1425A/July 18, 2001)

Also on July 18, 2001, the SEC filed a civil injunctive action against, among others, Weissman and Cantor for, among other things, violating the FCPA's anti-bribery provisions by causing ABNH to make the $239,000 illicit payment. *See SEC v. Morris Weissman, et al.*, 01 CV 6449 (S.D.N.Y.) (Lit. Rel. No. 17068A/AAER Rel. No. 1425A/July 18, 2001) The action was stayed pending Weissman's conviction for financial fraud on August 6, 2003. On July 17, 2001, in a criminal proceeding instituted by the U.S. Attorney's Office for the Southern District of New York, Cantor pled guilty to a criminal information charging that, among other things, he violated the FCPA.

9. *SEC v. International Business Machines Corporation*, 1:00CV03040 (D.D.C.) (Lit. Rel. No. 16839/December 21, 2000); *In the Matter of International Business Machines Corporation*, Admin. Proc. File No. 3-10397 (Sec. Ex. Act. Rel. No. 43761/AAER Rel. No. 1355/December 21, 2000)

   On December 21, 2000, the SEC entered a settled cease-and-desist order and filed a settled civil action in federal district court against IBM arising out of at least $4.5 million in payments to directors of

an Argentinean government-owned bank to secure a $250 million contract to integrate and modernize the bank's computer system. Senior management of IBM's wholly-owned Argentinean subsidiary, IBM-Argentina, S.A., caused the subsidiary to enter into a subcontract with another company, Capacitacion Y Computacion Rural, S.A. ("CCR"), pursuant to which IBM-Argentina paid CCR $22 million, at least $4.5 million of which was diverted to the bank officials. IBM-Argentina's senior management sought to conceal the bribes by, among other things, fabricating documents.

Without admitting or denying the SEC's findings, IBM consented to entry of an order that requires IBM to cease and desist from violating or causing any violation of the books-and-records provisions. Without admitting or denying the allegations in the complaint, IBM consented to the entry of a judgment ordering IBM to pay a $300,000 penalty.

## III. COUNSEL'S RESPONSE TO FCPA VIOLATIONS

### A. Requirements imposed pursuant to Sarbanes-Oxley.

1. Section 307 of the Sarbanes-Oxley Act required the SEC to set minimum standards of professional conduct for attorneys appearing or practicing before it in the representation of issuers. This included promulgating rules requiring attorneys representing issuers before the SEC to report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the issuer or by any officer, director, employee or agent of such issuer up the ladder within the company to the CEO or chief legal officer (or the equivalent thereof); and, if that person did not respond appropriately to the evidence, requiring the attorney to report the evidence to the audit committee, another committee of independent directors, or to the full board of directors.

2. On January 29, 2003, the SEC promulgated final rules pertaining to standards of professional conduct for attorneys, which became effective on August 5, 2003 (Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. Part 205)[2], and extended the comment period with respect to the "noisy withdrawal" proposal (*see* III.A.2.f below):

[2] A copy of the final regulations may be accessed at www.sec.gov/rules/final/33-8185.htm.

a. The SEC rules do prevail over inconsistent or conflicting laws of a state or U.S. jurisdiction. Specifically, the rule states, "[a]n attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices."

b. "Appearing or practicing before the SEC" means:

(1) Transacting any business with the SEC;

(2) Representing an issuer in connection with any inquiry or investigation, or administrative proceeding;

(3) Providing advice pertaining to the federal securities laws or rules and regulations regarding any document that the attorney has notice will be filed with, submitted to, or incorporated into any document that will be filed with or submitted to the SEC, including the provision of advice in the context of preparing, or participating in the preparation or, any such document; or

(4) Advising an issuer as to whether information is required to be filed with or submitted to the SEC under the federal securities laws and rules and regulations.

c. The obligation to report up the ladder arises when an attorney has "evidence of material violation."

(1) A "material violation" is defined as a "material violation of applicable United States federal or state securities law, a material breach of fiduciary duty arising under United Stated federal or state law, or a similar material violation of any United States federal or state law." The rule does not define "material," but the adopting release to the rule references the test for materiality set forth by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), namely that information is material if there is a substantial likelihood that it would be viewed by a reasonable investor as significantly altering the total mix of information available.

(2) "Evidence of a material violation" is defined to mean "credible evidence, based upon which it would be unreasonable in the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur."

d. An "appropriate response" means a response to an attorney as a result of which the attorney reasonably believes (based on an objective standard):

(1) that no material violation has occurred, is ongoing, or is about to occur;

(2) the issuer has, as necessary, adopted appropriate remedial measures; or

(3) the issuer, with the consent of the board, certain committees thereof, or a qualified legal compliance committee ("QLCC"), has retained or directed an attorney to review the reported evidence of a material violation and either:

(a) substantially implemented remedial measures recommended by such attorney; or

(b) been advised that the attorney may assert a colorable defense on behalf of the issuer relating to the reported evidence of a material violation.

e. An attorney is permitted to disclose to the SEC, without issuer consent, confidential information relating to the representation to the extent the attorney reasonably believes it necessary:

(1) to prevent the issuer from committing a material violation "that is likely to cause substantial injury to the financial interest or property of the issuer of investors;"

(2) to prevent the issuer from committing perjury before, or a fraud upon, the SEC;

(3) to correct a material violation by the issuer that "caused or may cause, substantial injury to the financial interest or property of the issuer or investors" if the attorney's services were used in furtherance of the violation; and

f. An attorney is also permitted to use any report or response thereto "in connection with any investigation, proceeding, or litigation in which the attorney's compliance with this part is in issue."

g. The SEC's initial proposed rules contemplated that, in some instances, if an attorney did not regard a response as appropriate, outside counsel was required to withdraw from representing the issuer, to notify the SEC of the withdrawal "for professional considerations," and to disaffirm any documents filed with or submitted to the SEC which the attorney had involvement in preparing and believed to contain materially false information. The SEC determined to extend the comment period on this proposed "noisy withdrawal" rule, and proposed an alternative for comment. This alternative would require outside counsel to notify the issuer of his withdrawal from representation, and the issuer, in turn, to report to the SEC within two business days the notification received from counsel, and the circumstances relating to the notification, i.e., "report out." The comment period has closed; the SEC has not yet promulgated a final rule.

h. With regard to state ethics rules, the SEC stated in its initial proposal dated November 21, 2002, "[t]he notification to the Commission prescribed by [the proposed noisy withdrawal rule] does not breach the attorney-client privilege."

B. ABA Model Rules of Professional Conduct[3]

1. In August 2003, the ABA's House of Delegates adopted the following amendments to the Model Rules of Professional Conduct:

a. Model Rule 1.13 (Organization as Client) has been amended to require that an attorney who knows that an officer, employee or other person associated with an organization, "is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, . . . that is likely to result in substantial injury to the organization," must proceed as is "reasonably necessary" in the best interest of the organization. This entails referring the matter to a higher authority in the organization, unless the attorney "reasonably believes that it is not necessary in the best interest of the organization." The attorney "may" report out confidential information to third parties if the board of directors, or authority inside the company to which the violative conduct was reported, fails to act, and it is clearly a violation of law which the attorney "reasonably believes . . . is reasonably certain to result in substantial injury to the organization." Rule 1.13 previously allowed attorneys to resign, but did not authorize them to report misconduct outside the company. Exempted from the application of Model Rule 1.13 are attorneys who are conducting internal investigations, or who are defending the organization or one of its officers or employees.

b. Model Rule 1.6 (Confidentiality of Information) has been amended to except from the confidentiality requirement imposed on attorneys situations in which the attorney, in his discretion, discloses confidential client information to prevent, mitigate or rectify substantial injury to the

[3] The ABA's Model Rules of Professional Conduct may be accessed at www.abanet.org/cpr.

financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used or is using the attorney's services. Rule 1.6 previously allowed attorneys to reveal information related to the representation of a client only if such disclosure was necessary to prevent "reasonably certain death or substantial bodily harm."

2. The ABA Rules serve merely as guidelines for states to adopt.

C. Florida Rules of Professional Conduct

1. Rule 4-1.6 (Confidentiality of Information)

2. Rule 4-1.13 (Organization as Client)