

FOREIGN CORRUPT PRACTICES ACT: CONSEQUENCES CAN HIT HOME

ISSUE

The Foreign Corrupt Practices Act (FCPA) of 1977 prohibits U.S. companies (public and private), U.S. citizens, permanent residents and certain non-U.S. individuals and entities from bribing foreign governmental officials in order to obtain or retain business. The FCPA has two main components:

- 1. THE ANTI-BRIBERY PROVISIONS.** Forbid offering or giving monetary bribes or “anything of value” to foreign government officials to secure unfair business advantages
- 2. THE ACCOUNTING PROVISIONS.** Require companies whose securities or debt are traded on U.S. exchanges to maintain adequate books, records and controls over financial transactions

The Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) are charged with enforcing the anti-bribery provisions, with the SEC being primarily responsible for enforcing the accounting provisions.

FCPA enforcement actions experienced a significant upsurge in 2008. Corporate penalties increased, with attention focused on the record Siemens fine (\$800 million) in December 2008, along with the more recent Halliburton settlement (\$559 million to settle charges involving bribery of Nigerian officials by a former business unit associated with the

construction of a gas plant). In July of this year, the U.S. SEC filed a settled enforcement action against Nature’s Sunshine Products Inc., a nutritional supplement manufacturer in Utah, after its subsidiary in Brazil allegedly bribed customs officials in 2000 and 2001 with more than \$1 million in cash to get its unregistered products into the country, where regulations had classified many of its products as medicines.

These examples are evidence that U.S. corporations with global operations face greater-than-ever exposure.

IMPACT

First, news of FCPA violations – or even investigations into potential violations – can have a negative effect on a company’s stock price, which in turn can result in federal securities class action litigation.

Second, criminal and/or civil actions against corporate directors and officers directly involved in corrupt practices may trigger the D&O policy’s “Insured Persons” coverage.

Third, an emerging trend by the SEC on holding individual officers personally liable for failing to implement sufficient internal controls to prevent FCPA violations (even if not themselves directly involved in corrupt practices) is cause for concern. Companies and their management face potential direct and derivative actions for breach of fiduciary duty, e.g., alleged failure to suitably manage corporate affairs resulting in FCPA liability. Finally, in the Nature’s Sunshine case, referenced above, the SEC, which claimed that the conduct violated the anti-bribery



provision of the FCPA and federal securities laws, also charged the company's chief executive officer, Douglas Faggioli, and chief financial officer, Craig D. Huff, alleging liability based on the ground that they were in "control" of the violators under Section 20(a) of the Securities Exchange Act of 1934. Under the proposed settlement, none of the defendants admitted liability, but the company agreed to pay a civil penalty of \$600,000, and each officer agreed to pay \$25,000. The case was the first FCPA action in which the SEC charged individuals under the Exchange Act's control liability theory, according to Philip Urofsky, a former federal prosecutor of FCPA claims who now is a partner in the Washington office of New York's Shearman & Sterling in a recent Article in The National Law Journal.

ACTION

Companies must prepare for increased governmental scrutiny, and while that starts with developing strong internal FCPA compliance programs, it also requires a re-evaluation of the company's directors and officers (D&O) liability insurance program, particularly in light of the FCPA's implications for the program.

UNDERSTAND THE IMPLICATIONS FOR YOUR D&O INSURANCE. Generally speaking, fines and penalties arising from an FCPA enforcement action won't be covered (as they fall outside the scope of a D&O policy's definition of "Loss") unless specifically endorsed onto your policy, nor will most internal board investigations. Even when available, coverage under a traditional ABC D&O policy may be restricted to certain FCPA sections, and some carriers will only offer a sub-limit. By comparison, there is greater potential for covering civil fines under your A-Side DIC program. These are areas in which we are working closely with carriers to maximize coverage where insurable by law.

CONDUCT FRAUD/DISHONESTY EXCLUSION. For broad coverage, be certain that the most expansive "final adjudication" wording has been negotiated into the policy to secure (at a minimum) defense costs coverage.

GLOBAL EXPOSURE. Recognize that other countries have equivalent laws in place and that any policy coverage should address all jurisdictions in which you operate.

CONTACTS

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