

Corporate Officers Beware: SEC Fines U.S. "Control Persons" for FCPA Violations of Foreign Subsidiary

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Enforcement of the Foreign Corrupt Practices Act ("FCPA"), the federal statute prohibiting bribery of foreign officials, is on the rise. But in a new twist, the Securities and Exchange Commission ("SEC") filed civil charges in July 2009 against two U.S.-based senior corporate officers on a theory that the executives were liable under the FCPA for the illegal acts of a foreign subsidiary based solely on their status as "control persons." This recent SEC action highlights an increased risk of personal liability for executives whose companies operate abroad.

In the case, *SEC v. Nature's Sunshine Products Inc., et al.*, the SEC filed a settled enforcement action against Nature's Sunshine Products, Inc. ("NSP"), a health supplement company, and two of its former officers, CEO Douglas Faggioli and CFO Craig Huff. The SEC alleged that Faggioli and Huff were liable for NSP's violations not because they were directly complicit, but because they were "control persons" under federal securities laws. The executives agreed to settle the allegations by paying a \$25,000 civil penalty each, and agreeing to a court order enjoining them from future violations.

The predicate for the allegations against Faggioli and Huff was NSP's violations of the FCPA's books and records provisions. These provisions require a securities issuer to keep records that accurately reflect its transactions and assets consistent with GAAP and maintain a system of internal accounting controls that provide reasonable assurances that no unauthorized payments are made or off-books accounts exist. The SEC held Faggioli and Huff responsible for NSP's violation of these provisions by means of Section 20(a) of the Securities Exchange Act of 1934, which provides that anyone "who, directly or indirectly, controls any person liable" is also liable to the same extent as such controlled person.

The SEC's complaint illustrates the expansive nature of control person liability because in the case of Faggioli and Huff, there was no allegation that the former officers were aware of the misconduct. According to the complaint, in 1999 Brazil changed its law to require companies selling health supplements to register their products. NSP's wholly-owned Brazilian subsidiary circumvented this new requirement by making cash payments to third-party customs brokers who passed on portions of the payments to Brazilian customs officials. In exchange, the officials allowed the import and sale of unregistered NSP products. NSP's Brazilian subsidiary improperly booked these payments as legitimate importation expenses.

In December 2000, the operations manager for the Brazilian subsidiary allegedly informed NSP employees that pressure from the Brazilian government made it difficult to locate a customs broker willing to import unregistered NSP products. As a result, the manager reported, the few available brokers were demanding fees as high as twenty-five percent of the shipment's value. An audit of the subsidiary's books revealed approximately eighty cash payments with no supporting documentation. Nevertheless, NSP accounted for the undocumented payments as import expenses in its 2001 consolidated financial statements.



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The only connection evident from the complaint between the executives and the illegal conduct was their supervisory roles in the preparation of NSP's financial statements and maintenance of its financial controls. The SEC alleged that such supervisory authority made the former officers liable under Section 20(a). While Section 20(a) is hardly new, the SEC's reliance on it here represents a significant departure from past FCPA enforcement efforts where regulators focused on those who allegedly were involved actively in corrupt behavior.

Corporate officers should take notice of the SEC's expanded use of control person liability. On September 24, 2009, Kara N. Brockmeyer, an Assistant Director in the SEC's Enforcement Division, publicly commented on the *Nature's Sunshine* case and opined that when the SEC brings charges against an executive under a control person theory, it is "signaling that it believes there were red flags" to which the executive "should have been paying attention." The allegations against NSP bear this out. For example, the undocumented payments could have triggered an investigation before NSP booked them as legitimate importation expenses. Moreover, the fact that brokers demanded excessive fees to import the supplements arguably should have alerted NSP management to the possibility that the brokers were bribing Brazilian officials. Although unstated in the SEC complaint, NSP management's failure to respond to these red flags quite possibly led the SEC to charge the two executives.

In addition to addressing red flags, corporate officers should take reasonable proactive measures to avoid FCPA trouble in the first place. Such measures include:

- Maintain a robust compliance and ethics program that includes all subsidiary corporations;
- Provide third-party agents, such as customs brokers and sales representatives, with anti-corruption training and require certifications that they understand and will abide by the FCPA;
- Conduct due diligence on potential agents and regularly review existing agent relationships; and
- Include audit and inspection rights in third-party agent contracts.

Section 20(a) provides an affirmative defense to any control person who acted in good faith and did not directly or indirectly cause the violation. But ignoring warning signs may well undermine that defense. Accordingly, corporate officers should not only respond promptly to red flags, but should ensure their compliance programs are appropriately designed and implemented to prevent, detect, and remedy wrongdoing.

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