

VOLUNTARY DISCLOSURE FOSTERING OVERENFORCEMENT AND OVERCRIMINALIZATION OF THE FCPA

*Karen E. Woody**

INTRODUCTION

Professor Peter Reilly's article¹ challenges the notion that voluntary disclosure of potential Foreign Corrupt Practices Act (FCPA) violations to the government is always the best course of action for a company. In a world where whistleblowers can receive a bounty for information provided to the Securities and Exchange Commission (SEC),² self-reporting is a critical, high-pressure decision that each company must undertake when faced with potential FCPA liability.

This Article takes a broader look at the FCPA landscape, focusing on SEC enforcement, in parallel to the Department of Justice (DOJ) focus that Professor Reilly undertakes in his Article. Specifically, this Article buttresses Professor Reilly's argument by pointing out that the SEC has become an increasingly prosecutorial agency that uses disgorgement as a punitive measure, and enjoys the ability to be both prosecutor and judge in a settlement-driven landscape. In practicality, this means the scales are tipped in the government's favor, making the decision whether to voluntarily disclose even murkier.

I. OVERENFORCEMENT AND OVERCRIMINALIZATION

As Professor Reilly points out in his Article, the FCPA was not an oft-charged statute until the 2000s.³ Specifically, from its enactment in 1977 until 2001, the SEC brought only nine enforcement actions under the FCPA.⁴ Since those original cases, the FCPA "industry," which includes both regulators and defense counsel, has enjoyed a boom that, to date, has not waned.

The rise of enforcement actions, often settled with deferred prosecution agreements (DPAs) or non-prosecution agreements (NPAs) as Professor Reilly points out, shows that the statute is now both overenforced and overcriminalized.⁵

* Assistant Professor of Business Law and Ethics, Indiana University, Kelley School of Business.

1. Peter R. Reilly, *Incentivizing Corporate America to Eradicate Transnational Bribery Worldwide: Federal Transparency and Voluntary Disclosure Under the Foreign Corrupt Practices Act*, 67 FLA. L. REV. 1683 (2015).

2. See, e.g., Press Release, Sec. & Exch. Comm'n, SEC Whistleblower Program Surpasses \$100 Million in Awards (Aug. 30, 2016), <https://www.sec.gov/news/pressrelease/2016-173.html>.

3. Reilly, *supra* note 1, at 1692.

4. See *SEC Enforcement Actions: FCPA Cases*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml> (last updated Oct. 5, 2016).

5. See Karen E. Woody, *No Smoke and No Fire: The Rise of Internal Controls Absent Anti-Bribery Violations in FCPA Enforcement*, 38 CARDOZO L. REV. (forthcoming 2017).

Overenforcement occurs when a violator of a legal rule suffers excessive harm due to the actual implementation of the rule.⁶ Excessive harm in the case of overenforcement is harm that is greater than what is required for optimal deterrence.⁷ Likewise, overcriminalization is broadly defined as “the overuse and misuse of the [] law to punish conduct traditionally deemed morally blameless.”⁸ Overcriminalization results in enforcement of laws that cover “more conduct than anyone really wishes to punish.”⁹ Although SEC enforcement actions are, by definition and institutional design, *civil* proceedings, the concept of overcriminalization is equally applicable with respect to civil SEC enforcement actions as it is to criminal actions. I contend that overcriminalization is manifested in three areas. First, the SEC as an agency, and certainly when investigating potential FCPA violations, has become much more of a prosecutorial institution than a remedial one. Second, the use of disgorgement as a punitive measure rather than a remedial one is a sign of overcriminalization in the sentencing stage. Third, there is a substantial lack of judicial precedent within the common law regarding enforcement of the internal controls provision, rendering the SEC (and DOJ) both prosecutor and judge during settlement negotiations. This section will explore these three manifestations of overcriminalization, resulting in zealous overenforcement of the statute. All of this factors into a company’s decision regarding voluntary disclosure, but paints with broader strokes the landscape in which a company has to make that decision.

A. The Evolution of the SEC’s Enforcement Division into Prosecutorial Body

In recent history, the Enforcement Division of the SEC has swallowed up the agency, both in resources/manpower and in setting the tone of the agency.¹⁰ It is widely seen as the “police force” for the SEC.¹¹ Indeed, the SEC Chair, Mary Jo White, a former prosecutor, underscored that prosecutorial tone when she adopted her “no broken windows” policy for

6. Richard A. Bierschbach & Alex Stein, *Overenforcement*, 93 GEO. L.J. 1743, 1744 (2005).

7. *Id.*

8. Todd Haugh, *Overcriminalization’s New Harm Paradigm*, 68 VAND. L. REV. 1191, 1197, 1198 (2015) (quoting Paul J. Larkin, Jr., *Regulation, Prohibition, and Overcriminalization: The Proper and Improper Use of the Criminal Law*, 42 HOFSTRA L. REV. 745 (2014)).

9. William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 507 (2001).

10. Cf. Max Minzner, *Should Agencies Enforce?*, 99 MINN. L. REV. 2113, 2143–44 (2015).

11. *How the SEC’s Enforcement Division is Responding to Cybersecurity Challenges*, MORNINGSTAR (Oct. 21, 2016), http://www.morningstar.com/news/benzinga/BenzBZW_8588833/how-the-secs-enforcement-division-is-responding-to-cybersecurity-challenges.html.

the agency.¹² Yet, the SEC is not an arm of the Department of Justice. This fact is lost on most corporate officers who face the same level of investigation and threat of punishment regardless of whether it is the SEC or DOJ that comes calling. In short, the Enforcement Division has rendered the SEC an agency with overwhelming “police power,” at the expense of its role focusing on guidance and remedial measures to keep corporations in line.

Enforcement of the FCPA is no different; the drastically increasing fines and prosecutions for violations of the FCPA since 2000 has arguably made the FCPA one of the “hottest” areas in the Enforcement Division.¹³ Since 2010, the SEC has an FCPA unit within the Division of Enforcement.¹⁴ Contrary to the organizational structure and design of the agency, the Enforcement Division is regulating and influencing corporate behavior through punishment, rather than providing agency guidance through other means.¹⁵

The hard-charging enforcement of all of the Act’s provisions is not in line with the initial intent of the Act. In a speech given in 1981 that manifested some of the initial and original intent of the statute, the then-Chairman of the SEC Harold Williams stated the following about the FCPA in a speech to the American Institute of Certified Public Accountants:

The Act’s eventual success or failure will, therefore, depend primarily upon business’s response. The Commission’s obligation, in turn, is to provide a regulatory environment in which the private sector can address these issues meaningfully and creatively. In this regard, we must encourage public companies to develop innovative records and control systems, to modify and improve them as circumstances change, and to correct recordkeeping errors when they occur without a chilling fear of penalty or inference that a violation of the Act is involved.¹⁶

12. Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Remarks at Securities Enforcement Forum (Oct. 9, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100> (citing George L. Kelling & James Q. Wilson, *Broken Window*, THE ATLANTIC (March 1982), <http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/>).

13. Wentong Zheng, *The Revolving Door*, 90 NOTRE DAME L. REV. 1265, 1289 (2015).

14. Press Release, U.S. Sec. & Exch. Comm’n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010) <https://www.sec.gov/news/press/2010/2010-5.htm>.

15. See Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 L. & CONTEMP. PROBS. 33, 34 (1998) (describing how the SEC frequently makes law through enforcement cases rather than through rulemaking).

16. Harold M. Williams, Chairman, U.S. Sec. & Exch. Comm’n, *The Accounting Provisions of the Foreign Corrupt Practices Act: An Analysis* (Jan. 13, 1981), <https://www.sec.gov/news/speech/1981/011381williams.pdf>.

The notion of “encouraging” companies and “correcting errors” without “fear of penalty” is more in line with the guiding principles of other departments in the agency rather than the “broken windows” policies of the Enforcement Division. For example, the Office of Compliance, Inspection and Examinations (“OCIE”) regularly inspects registered entities, yet does so without playing “gotcha” with the regulated entities.¹⁷ The same can be said in the context of voluntary disclosure; that is, when the government is hard-charging and seemingly intent on extracting large fines and individual liability, voluntary disclosure does not look as appealing as it may have in a more “remedial” regime at the SEC.

B. *The Problem with Disgorgement*

The trend in enforcement actions by the DOJ, as described by Professor Reilly,¹⁸ parallels the uptick in large settlement amounts extracted by the SEC that consist entirely of disgorgement and prejudgment interest without any finding of a violation of the anti-bribery provisions. This type of fine is oft-termed “no-charged bribery disgorgement.”¹⁹ These fines represent a punitive settlement rather than an equitable one. A former associate director of the SEC’s Enforcement Division summarized this concept by stating:

[S]ettlements invoking disgorgement but charging no primary anti-bribery violations push the law’s boundaries, as disgorgement is predicated on the common-sense notion that an actual, jurisdictionally-cognizable bribe was paid to procure the revenue identified by the SEC in its complaint. . . . Given the bedrock principle that a court’s equitable power to order such disgorgement only goes as far as the scope of the violation, it is difficult to determine how a court could lawfully allow disgorgement of profits for uncharged violations without the remedy crossing into the line of “punishment” for the violations actually charged.²⁰

In order to obtain disgorgement, the government needs to prove a causal link between the wrongdoing and the unjust enrichment.²¹ In the

17. See Andrew Bowden, Dir., SEC Office of Compliance Inspections and Examinations, *People Handling Other Peoples’ Money* (May 6, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370541260300>.

18. Reilly, *supra* note 1, at 1692.

19. See, e.g., Mike Koehler, *Why You Should Be Alarmed by the ADM FCPA Enforcement Action*, 9 WHITE COLLAR CRIME REP. 58, 61 (2014).

20. Paul Berger, *Do FCPA Remedies Follow FCPA Wrongs? “Disgorgement” in Internal Controls and Books and Records Cases*, 3 DEBEVOISE & PLIMPTON LLP FCPA UPDATE 1, 2–4 (2011) (footnotes omitted).

21. See, e.g., SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

case of no-charged bribery disgorgement, there typically is not any direct link between profits and allegations of misconduct, rendering the fines associated with no-charged bribery cases punitive in nature. The FCPA²² contains very specific guidelines and penalties for violations of both the anti-bribery and accounting provisions of the Act.²³ Fines imposed for bribery are not part of the SEC's § 21(d) fining authority,²⁴ but were included into the Exchange Act as part of the 1988 Amendments to the FCPA.²⁵

Disgorgement, however, is not included in the statute, nor is it even mentioned in the original House or Senate reports of 1977, the discussion regarding its amendments, or the 1981 U.S. General Accounting Office Report.²⁶ The first use of disgorgement in the settlement of an FCPA action was in 2004, in the case of *SEC v. ABB Ltd.*²⁷ Since that time, the SEC has sought disgorgement "in virtually every FCPA enforcement action it has brought."²⁸ Accordingly, the imposed fines give the impression the company received ill-gotten gains. Yet, a cursory look at recent SEC enforcement actions involving disgorgement makes clear the company received no ill-gotten gains as a result of bribery.

By definition, disgorgement should not be a punitive remedy. It should be used to separate the bad actor from any ill-gotten gains. However, the use of disgorgement in FCPA enforcement actions seems to serve the purposes of both deterrence and retribution: decidedly punitive goals. This is problematic when there are no ill-gotten gains under the meaning of the statute; that is, there has not be any contract or business retained or obtained through the use of bribes to foreign officials, nor has there been any illegal accounting methods to hide those bribes. To punish a company for this conduct flies in the face of both the purpose of the statute and the remedial options available to the government when pursuing these allegations.

Consider this problem of disgorgement in the context of voluntary disclosure, and in the context of Professor Reilly's significant analysis. Although Professor Reilly discussed recent cases in terms of DOJ fines

22. Foreign Corrupt Practices Act, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78dd-1–78dd-3 (2012)).

23. 15 U.S.C. §§ 78dd-2(g); 78dd-3(e); 78ff (2012).

24. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a–78pp (2012)).

25. 15 U.S.C. § 78ff(c) (2012).

26. See David C. Weiss, Note, *The Foreign Corrupt Practices Act, SEC Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and Deterrence*, 30 MICH. J. INT'L L. 471, 497 (2009).

27. No. 1:04CV1141, 2009 WL 2129216 (D. D.C. 2010). ABB disgorged \$5.9 million to settle books and records and internal controls violations. *Id.*

28. Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT'L L. 907, 982 (2010) (internal quotations omitted).

as they related to the Sentencing Guidelines,²⁹ the argument is both analogous and valid. Voluntary disclosure of potential FCPA violations, *even where no ill gotten gains were had*, nevertheless can result in significant disgorgement remedies, and must be considered in the overall calculus of whether to voluntarily disclose or not.

C. Arbitrariness in Enforcement and Settlements

Professor Reilly astutely notes that companies need specific and detailed guidance and direction regarding how to stay in compliance with the FCPA.³⁰ In turn, companies need to create and engage a robust compliance program in order to detect and prevent FCPA violations. Despite a seemingly clear statutory mandate for establishing an internal controls regime, there is a fair amount of gray area in terms of what constitutes adequate internal controls and compliance procedures. This concept was captured in 1983, when a federal district court stated, “[t]he main problem with the internal accounting controls provision of the FCPA is that there are no specific standards by which to evaluate the sufficiency of controls; any evaluation is inevitably a highly subjective process in which knowledgeable individuals can arrive at totally different conclusions.”³¹

Few courts have ruled on FCPA internal control violations because most defendants settle. There is accordingly little judicial precedent surrounding compliance programs. The downside to looking merely to DOJ and SEC settlement agreements for legal standards regarding compliance programs is that the settlement agreements are created by prosecutors without judicial oversight.³² In practicality, the SEC acts as both prosecutor and judge, without much regard toward previous settlements.

As such, SEC enforcement attorneys are able to shape the entire landscape of the statutory enforcement.³³ As the ultimate decision-makers, they decide what actions constitute a violation of the code, whether to investigate, whether to bring an enforcement action, and whether and for what amount to settle the action.³⁴ All of this occurs without judicial review, up until acceptance of the settlement action by

29. See Reilly, *supra* note 1, at 1700–10.

30. *Id.* at 1700.

31. SEC v. World-Wide Coin Invs., 567 F. Supp. 724, 751 (N.D. Ga. 1983).

32. See Peter J. Henning, *Appeals Court Ruling in S.E.C. Case Will Curb Judicial Power over Settlements*, DEALBOOK (June 4, 2014), http://dealbook.nytimes.com/2014/06/04/appeals-court-ruling-in-s-e-c-case-will-curb-judicial-power-over-settlements/?_r=0.

33. See David Hess, *Combating Corruption Through Corporate Transparency: Using Enforcement Discretion to Improve Disclosure*, 21 MINN. J. INT'L L. 42, 62–63 (2012).

34. See generally Minzner, *supra* note 10 (outlining the vast discretion afforded to enforcing agencies when making charging decisions).

the court. The ability to cherry-pick cases and the arbitrary nature of settlement agreements without any precedential value results in a lack of checks and balances—and, arguably, due process—for a corporate defendant unwilling to take its chances in court for any number of reasons. Similarly, a corporate defendant also is less likely to “raise its hand” and voluntarily disclose FCPA violations when the parameters for compliance and the existence of a robust internal controls systems seem to be moving targets.

II. THE RESULT OF OVERENFORCEMENT: OVERCOMPLIANCE AND POTENTIALLY DISASTROUS VOLUNTARY DISCLOSURES

Overcriminalization and overenforcement of the FCPA have created a necessary culture of compliance among many large issuers. However, neither the DOJ nor the SEC have explicitly stated what a model compliance program must contain to satisfy the internal controls requirement. As such, the critical decision regarding whether to voluntarily disclose potential FCPA violations is made even trickier. Both the DOJ and the SEC have, however, indicated when companies have satisfied or failed to satisfy the standard through their settlement decisions and non-prosecution agreements. However, the arbitrariness in the enforcement of the FCPA results in a real risk of overcompliance, as vast resources are spent on compliance systems that may be either insufficient in the eyes of the regulators, or worse, wholly ineffective.

In fact, a growing body of evidence indicates that internal compliance structures do not deter prohibited conduct within firms and may largely serve a window-dressing function that provides both market legitimacy and reduced legal liability. . . . This leads to two potential problems: (1) an under-deterrence of corporate misconduct, and (2) a proliferation of costly—but arguably ineffective—internal compliance structures.³⁵

Compliance is very forward-looking in its risk-assessments and structures. However, compliance systems are informed by the most recent regulatory actions. As such, they are inherently reactive to regulatory action. In this way, compliance systems may be a house of cards doomed to fail, because those who skirt compliance measures do so in continually novel ways. The DOJ and SEC have been reluctant to define the exact content of an FCPA compliance program, because they want companies to continuously improve their compliance programs when their programs are either found to be ineffective or the industry adopts better standards. For example, in the DOJ’s non-prosecution agreement with IAP

35. Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491 (2003).

Worldwide Services, Inc., the DOJ settled without prosecution partly because IAP promised to take remedial compliance measures.³⁶ These measures included conducting periodic reviews and testing of anti-corruption measures and policies in order to maintain effectiveness and improve with recent developments.³⁷ By requiring such measures, it is difficult to establish a definitive program that will satisfy the internal controls requirement—a compliance program deemed effective and sufficient today may be found to be ineffective or outdated in the future, particularly if a company falls behind changing standards for compliance within its field.

Compliance, in addition to voluntary disclosure, is a corporate cost-benefit exercise.

Companies may be willing to enter into such settlements—particularly because, in the absence of a parallel DOJ action, they need not make any factual admissions (due to the “neither admit nor deny” nature of SEC settlements in such circumstances), and the cost of a settlement is often lower than continuing investigative and representative costs. But such settlements can have severe, unintended consequences. Perhaps most significantly, these settlements can lead other companies to misdirect their scarce compliance resources.³⁸

As such, compliance professionals and counsel must continually change guidelines, but without the benefit of “hard” precedent. Instead, they rely on the “soft” precedent of settlement agreements, as well as increasingly stricter standards for internal controls measures, and a playing field that is decidedly a home-court advantage for the regulators. Of course, the question of how robust to make one’s compliance program is directly analogous to the decision regarding whether to voluntarily disclose. As Professor Reilly shows, that decision is not a clear-cut line, and in many cases, voluntary disclosure is not worth the corporate costs. The risk inherent in voluntary disclosure, therefore, increases exponentially when compliance is not defined. Similarly, extending corporate resources to buttress robust corporate compliance programs may be throwing money into the wind.

36. Press Release, Dep’t of Justice, IAP Worldwide Services Inc. Resolves Foreign Corrupt Practices Act Investigation (June 16, 2015), <http://www.justice.gov/opa/pr/iap-worldwide-services-inc-resolves-foreign-corrup-practices-act-investigation>.

37. *Id.*

38. William J. Stuckwisch & Matthew J. Alexander, *The FCPA’s Internal Controls Provision: Is Oracle an Oracle for the Future of SEC Enforcement?*, 28 CRIM. JUST. 10, 15 (2013).

CONCLUSION

The FCPA is a complex and intriguing statute, the enforcement of which has evolved drastically since its passage in 1977. Recent enforcement actions have put the spotlight on the benefits and costs of voluntary disclosure. Professor Reilly makes a significant contribution to the literature by analyzing the real risks in voluntary disclosure, as evidenced by a number of recent DOJ cases. In a broader sense, the real danger lurking in FCPA enforcement is overenforcement and overcriminalization of the statute. Just as a lack of benefit for voluntary disclosure shows, overenforcement and overcriminalization have a negative deterrent effect, and likely will do more harm than good in terms of fulfilling the statutory purpose of eradicating foreign bribery, and in ensuring companies are undertaking reasonable steps to comply with the statute and establish robust internal controls.