The FCPA's Internal Controls Provision

Is *Oracle* an Oracle for the Future of SEC Enforcement?

Imagine the following scenario: You have guided your client, a publicly traded company, through the long and winding process that is a Foreign Corrupt Practices Act (FCPA) internal investigation. Afterward, or increasingly more often simultaneously, you then lead your client through presentation of the results of the investigation to the United States Department of Justice (DOJ) and Securities and Exchange Commission (SEC) (collectively, "government"). Ultimately, neither the internal investigation nor the government's investigation finds any improper payment (or offers of payments) to any foreign official, or any other knowing misconduct. As a result, the government cannot pursue substantive FCPA antibribery charges against your client, and the DOJ cannot pursue any other FCPA-related criminal charges. Just when you begin to savor this significant success, you are ripped back to reality, as the SEC informs you that, nevertheless, your client faces civil enforcement under the FCPA's internal controls provision and demands a significant penalty.

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IMAGE ■ iSTOCK

Unfortunately, this scenario is not a hypothetical for the FCPA Bar to deliberate at conferences and include as footnotes in memoranda addressing real-world client issues. Instead, it mirrors the facts publicly alleged in the SEC's August 2012 enforcement action against Oracle Corporation, a case considered by many FCPA practitioners to be a stunning result. (SEC v. Oracle Corp., No. 3:12-cv-04310 (N.D. Cal. Aug. 13, 2012); Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Oracle Corporation With FCPA Violations Related to Secret Side Funds in India (Aug. 16, 2012), http://tinyurl.com/9e42byx.)

In *Oracle*, the SEC faulted the US parent corporation for not auditing local distributors hired by its Indian subsidiary, without alleging that the distributors (or anyone else) had made any improper payment to any foreign government official. *Oracle* is the latest example of the SEC's expansive enforcement of the FCPA's internal controls provision, and it potentially paints a bleak picture—one in which the provision is essentially enforced as a strict liability statute that means whatever the SEC says it means (after the fact). *Oracle* highlights the SEC's ability to bring a (settled) enforcement action against virtually any public company investigated for potential FCPA improper payments by alleging that some aspect of the company's internal controls was insufficient, regardless of whether anyone knew of the weakness at the time.

Accordingly, *Oracle* invites many questions. Is the statute really that broad? How did we get here, should we have seen *Oracle* on the horizon, and just how harsh is this post-*Oracle* reality? What does *Oracle* tell us about the SEC's views on necessary internal controls? Last, but most importantly, where can counsel and clients go from here?

Perhaps time will ultimately deem *Oracle* an aberration. Other (arguably) overly aggressive SEC actions, such as the 2009 FCPA case against Nature's Sunshine Products executives, have not been repeated (at least not yet). (*See, e.g.*, Complaint at ¶¶ 43–48, 66–69, SEC v. Nature's Sunshine Prods., Inc., No. 2:09-cv-0672 (D. Utah July 31, 2009), *available at* http://tinyurl.com/mltpupo (describing "control person" basis for books-and-records and internal controls provision liability).) Further, the government's long-awaited *FCPA Guide*—published just a few weeks after *Oracle*—recognizes that some SEC FCPA investigations should not result in enforcement. (Criminal Div., U.S. Dep't of Justice & Enforcement Div., U.S. Sec. & Exch. Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act 77 (2012) [hereinafter FCPA Guide], *available at* http://tinyurl.com/cwj85jx.) Finally, the SEC's decision to forego enforcement against Morgan Stanley—despite an action against its former employee for both foreign bribery and internal controls evasion—confirms the possibility of an outright declination. (Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Former Morgan Stanley Executive with FCPA Violations and Investment Adviser Fraud (Apr. 25, 2012), http://tinyurl.com/8xxocec [hereinafter SEC Morgan Stanley Press Release].)

Unfortunately, however, given the highly subjective nature of the internal controls provision, companies will continue to feel at the SEC's mercy once it opens an FCPA investigation, even if no improper payments (or offers of payments) are ever found. Several proactive steps can help mitigate this feeling. First, companies should evaluate and enhance their internal controls (as appropriate) long before any investigation begins. Second, at the outset of any SEC FCPA investigation, counsel should devote significant attention to the state of their client's internal controls, not just to whether the government can prove an antibribery charge. Finally, counsel should seek to demonstrate not only that the internal controls were sufficient, but also that the SEC should exercise its discretion to reward their client for genuine efforts to implement effective internal controls, even if SEC hindsight generates critique.

The Internal Controls Provision

In 1977, as part of the fallout from the Watergate scandal, the FCPA was enacted after more than 400 corporations reported making corrupt payments to foreign government officials, totaling over $300 million, while also filing inaccurate corporate financials to hide such payments. (Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78 *et seq.* (Supp. II 1979); *see* H.R. Rep. No. 95-640; S. Rep. No. 95-114; Sec. & Exch. Comm'n, 94th Cong., Rep. on Questionable and Illegal Corporate Payments and Practices 2–3 (Comm. Print 1976).) The core of the statute is its antibribery prohibitions, barring the bribery of foreign government officials to win or keep business. The antibribery prohibitions are complemented by accounting provisions that include the internal controls provision as a second prong (with the books-and-records provision being the first). The FCPA received little attention in its early years; indeed, the SEC originally wanted no role in enforcing such a law. After amendments in 1988 and 1998, enforcement of the FCPA began in earnest in the mid-2000s; however, relatively little focus was given to its internal controls provision at the time. (Omnibus Foreign Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107; International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302.)

Who Is Subject to the Internal Controls Provision?

Jurisdictional coverage of the FCPA's internal controls provision is narrower than that of its substantive antibribery counterparts, leaving many companies unaffected by the SEC's expansive enforcement practices. While it is colloquially understood to apply to publicly-traded

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companies, the internal controls provision actually applies more broadly to all "issuers," a group not limited solely to US companies. For FCPA purposes, issuers are those entities with a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that are required to file reports (periodic or otherwise) under section 15(d) of the same, a group that includes foreign entities with American depository receipts listed on a US exchange. (15 U.S.C. §§ 78l, 78o(d) (2011).)

Issuers are responsible not only for their own internal controls, but also for those of their subsidiaries around the world. It is this extended responsibility for far-flung conduct that is often the source for expansive interpretations like *Oracle*, where the conduct occurred at the company's Indian subsidiary. However, the FCPA does limit the obligations of parent companies with respect to the internal controls of subsidiaries and/or affiliates when the parent holds voting power of 50 percent or less. In these instances, all that is required are good faith efforts by the parent to ensure the sufficiency of the subsidiary's or affiliate's internal controls. Parent efforts vis-à-vis subsidiaries and affiliates that it does not control are judged on a case-by-case basis by weighing all facts presented, with the statute requiring consideration of parental ownership interests and "the laws and practices governing the business operations of the country in which such firm is located." (15 U.S.C. § 78m(b)(6) (2011).)

What Does the Statute Require?

Though enacted as part of the FCPA and, at least in part, to deter foreign bribery, the internal controls provision's reach extends beyond foreign bribery cases. Specifically, the provision requires that issuers:

> devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—
> (i) transactions are executed in accordance with management's general or specific authorization;
> (ii) transactions are recorded as necessary
>   (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and
>   (II) to maintain accountability for assets;
> (iii) access to assets is permitted only in accordance with management's general or specific authorization; and
> (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences . . . .

(*Id.* § 78m(b)(2)(B).)

Thus, an internal accounting controls system does not have to be perfect; rather, it need only provide "reasonable assurances." As with the parallel "reasonable detail" qualification to the books-and-records provision, "reasonable assurances" is further defined by the statute as "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." (*Id.* § 78m(b)(7).) Coupled with the fuel of this highly subjective definition is the absence of any scienter requirement for civil liability—which serves as an accelerant for expansive SEC enforcement. In contrast, criminal liability under the internal controls provision attaches only when an entity "knowingly" circumvents or fails to implement sufficient controls. (*Id.* § 78m(b)(4)–(5).)

There is a dearth of case law on the meaning of the internal controls provision, as is true with respect to judicial consideration of the FCPA more generally. Indeed, the provision has yet to be judicially examined in a case involving alleged foreign bribery. Its most extended treatment appears in the SEC's oft-overlooked 1983 action against World-Wide Coin Investments. (SEC v. World-Wide Coin Invs., Ltd., 567 F. Supp. 724 (N.D. Ga. 1983).) While otherwise unremarkable, *World-Wide Coin* succinctly highlighted the concepts of reasonableness and proportionality embodied within the internal controls provision:

> "[R]easonable assurances" . . . recognizes that the costs of internal controls should not exceed the benefits expected to be derived. It does not appear that either the SEC or Congress . . . intended that the statute should require that each affected issuer install a fail-safe accounting control system at all costs. It appears that Congress was fully cognizant of the cost-effective considerations which confront companies . . . and of the subjective elements which may lead reasonable individuals to arrive at different conclusions. Congress has demanded only that judgment be exercised in applying the standard of reasonableness. . . . It is also true that the internal accounting controls provisions contemplate the financial principle of proportionality—what is material to a small company is not necessarily material to a large company.

(*Id.* at 751.)

Despite this elucidation, the facts presented in *World-Wide Coin* did not provide meaningful opportunity to explore application of these nuanced contours in a manner useful for today's well-meaning companies. As with many early internal controls enforcement actions, *World-Wide Coin* was an easy case, given that it involved an environment essentially devoid of controls. Nevertheless, *World-Wide Coin* spotted the fundamental issue that ultimately has enabled the SEC to bring cases like *Oracle*: "The main problem with the internal accounting controls provision . . . 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." (*World-Wide Coin*, 567 F. Supp. at 751.)

What the Government Says the Provision Requires

The SEC's settled enforcement actions have been an additional source of guidance (albeit somewhat limited) about its views on the meaning of the internal controls provision. For example, in numerous actions leading up to *Oracle*, the SEC has made clear its view that, even if it cannot assert an antibribery count, either because there is not sufficient evidence of foreign bribery or because there is no US jurisdiction, it can (and will) bring an internal controls charge. (*See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC Files Settled Civil Action Charging NATCO Group Inc. with Violations of the Foreign Corrupt Practices Act (Jan. 11, 2010), http://tinyurl.com/mafgwyg.) The SEC has also staked out its position that disgorgement of profits, as well as civil penalties, are available remedies for internal controls violations, even in the absence of antibribery charges. (*See, e.g.*, SEC v. Textron, Inc., No. 07-cv-1505 (D.D.C. Aug. 23, 2007).)

In some cases, counsel and their clients must draw inferences about the SEC's interpretation of the internal controls provision, as the SEC has simply asserted that, because improper payments occurred, the defendant company's internal controls were insufficient, without identifying a failure to implement or maintain any particular control. (*See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges California Telecommunications Company with FCPA Violations (June 29, 2010), http://tinyurl.com/2v9fj6q [hereinafter SEC Veraz Networks Press Release].) More commonly, however, SEC cases have found fault with the failure to implement or maintain specific internal controls, becoming expansively prescriptive in this approach. (*See, e.g.*, SEC v. ENI, S.p.A., No. 4:10-cv-02414 (S.D. Tex. July 7, 2010) (citing lack of due diligence on agents); SEC v. Titan Corp., No. 05-0411 (D.D.C. Mar. 1, 2005) (citing lack of a formal FCPA policy or procedures).)

In November 2012, the government published its *FCPA Guide* in an effort to provide businesses with more information about its FCPA enforcement views and approach. In it, the government defines internal controls processes to

> include various components, such as: a control environment that covers the tone set by the organization regarding integrity and ethics; risk assessments; control activities that cover policies and procedures designed to ensure that management directives are carried out (e.g., approvals, authorizations, reconciliations, and segregation of duties); information and communication; and monitoring.

(FCPA Guide, *supra*, at 40.)

Further, according to the government's *FCPA Guide*, "an effective compliance program is a critical component of a company's internal controls and is essential to detecting and preventing FCPA violations." (FCPA Guide, *supra*, at 56.) Beginning in 2005, the DOJ has included a list of minimum elements of an anticorruption compliance program and internal controls system in its FCPA settlement documents, requiring the settling company to implement such controls as:

- Policies and procedures applicable not only to employees but also, where necessary and appropriate, outside parties acting on the company's behalf in foreign jurisdictions addressing enumerated risk areas such as gifts, entertainment, travel, political contributions, charitable donations, facilitation payments, and extortion;
- Periodic risk assessments addressing the company's particular foreign bribery risks;
- Periodic training of not only employees but also, where necessary and appropriate, agents and business partners;
- Appropriate due diligence and compliance requirements pertaining to the retention and oversight of agents and business partners; and
- Monitoring and testing mechanisms.
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(*See, e.g.*, Non-Prosecution Agreement Between U.S. Dep't of Justice & Ralph Lauren Corp., Attachment B: Corporate Compliance Program (Apr. 22, 2013) [hereinafter Ralph Lauren Non-Prosecution Agreement], *available at* http://tinyurl.com/n75zmw5.)

Practically speaking, it becomes difficult to imagine business processes not encompassed within these government formulations of internal controls; yet, on the flip side, the government continues to recognize the FCPA's concepts of proportionality and reasonableness, concepts that give companies leeway to establish internal controls appropriate for their businesses: "The Act does not specify a particular set of controls that companies are required to implement. Rather, the internal controls provision gives companies the flexibility to develop and maintain a system of controls that is appropriate to their particular needs and circumstances." (FCPA Guide, *supra*, at 40.) Further, the *FCPA Guide* concedes that this inherently remains a case-by-case endeavor:

> Fundamentally, the design of a company's internal controls must take into account the operational realities and risks attendant to the company's business, such as: the nature of its products or services; how the products or services get to market; the nature of its work force; the degree of regulation; the extent of its government interaction; and the degree to which it has operations in countries with a high risk of corruption. A company's compliance program should be tailored to these differences. Businesses whose operations expose them to a high risk of corruption will necessarily devise and employ different internal

> controls than businesses that have a lesser exposure to corruption, just as a financial services company would be expected to devise and employ different internal controls than a manufacturer.

(*Id.*)

As noted in *World-Wide Coin*, tension will always arise in balancing these competing notions.

Separate and apart from this tension, serious questions also remain as to whether the SEC's current (apparent) formulation of the internal controls provision—one that essentially conflates the provision's requirements for sufficient "internal *accounting* controls" with the continually evolving elements of an "effective" compliance program (which, for purposes of securing credit during corporate sentencing, has been defined by the US Sentencing Commission *Guidelines Manual*)—is even a proper definition. (*See* U.S. Sentencing Guidelines Manual § 8B2.1 (2012).) This article does not attempt to tackle this separate question; however, it is worth noting that even the *FCPA Guide* states that internal controls over financial reporting are limited to "the processes used by companies to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements," suggesting that the SEC's formulation may go too far. (FCPA Guide, *supra*, at 40.) Certainly issuers should have compliance programs, and those with international operations should make sure they address the FCPA (and other countries' applicable anticorruption laws) for a whole host of reasons, but just what those programs include should be guided by individual, risk-based assessments, rather than preconceived definitions.

The *Oracle* Enforcement Action

Despite its subjective standards and the absence of any civil mens rea constraint, the internal controls provision seemed relatively navigable for companies and their counsel before *Oracle*. To be sure, the nature of SEC inquiries into the sufficiency of internal controls, conducted with the benefit of 20/20 hindsight after an often lengthy search for evidence of foreign bribery, left plenty of room for disagreement as to the appropriateness of any given enforcement action. But relative comfort could be (and was) derived from the fact that, when viewed against the informal authority existing in the form of settled enforcement actions, most internal controls cases involved relatively clear failures to implement fairly obvious internal controls. However, even the cases that appeared to expand the SEC's formulation of the internal controls provision did not presage the leap to *Oracle*.

Oracle, like many companies in the software industry, sold its product to Indian government customers via local distributors. The *Oracle* enforcement action involved allegations that employees of Oracle's wholly-owned Indian subsidiary structured sales to the Indian government so as to enable local distributors to "park" proceeds of the sales in unauthorized "side funds." (Complaint, SEC v. Oracle Corp., No. 3:12-cv-04310 (N.D. Cal. Aug. 13, 2012) [hereinafter Oracle Complaint], *available at* http://tinyurl.com/l3wcbs5.) The subsidiary's employees then directed distributors to use these side funds to pay third parties for purported marketing and development expenses. The SEC's complaint does not include any allegation that Oracle, its Indian subsidiary, or the subsidiary's distributors made any improper payments to any government official from the side funds (or any other source); it alleged only that the side funds "created a risk that the funds *potentially could be used* for illicit means, such as bribery or embezzlement." (*Id.* ¶ 13 (emphasis added).) While there were allegations of payments to "unauthorized third parties," there were no allegations that those third parties either were government officials or used the unauthorized payments to reach government officials. Thus, the SEC did not charge—and on these alleged facts, could not have charged—Oracle with a substantive antibribery count.

Nevertheless, the SEC pursued books-and-records and internal controls violations and collected a $2 million civil penalty. It is widely recognized that, from an anticorruption perspective, India is a high-risk country in which to operate, and it is not surprising that the SEC would expect an issuer operating in India to have procedures and controls commensurate with that risk. (*See, e.g.*, *Corruption Perceptions Index 2012*, Transparency Int'l, http://tinyurl.com/bv849o6 (last visited July 26, 2013).) As is somewhat typical, the SEC's complaint alleges few facts relating to Oracle's existing internal controls. However, from the complaint's recitation of Oracle's subsequent remedial measures, it can be gleaned that the company's preexisting internal controls included at least some level of due diligence on its partner transactions in India, as well as some anticorruption training for employees and partners. (Oracle Complaint, *supra*, ¶ 20.) Additionally, the parking of funds violated Oracle's corporate policies. (*Id.* ¶ 15.)

In particular, the SEC alleged three internal controls "failures": (1) Oracle lacked the proper controls to prevent its employees at Oracle India from creating and misusing the parked funds; (2) Oracle failed to audit and compare distributors' margins against the end-user price to ensure excess margins were not being built into the pricing structure; and (3) Oracle failed to seek transparency in or audit third-party payments made by distributors on Oracle's behalf. (*Id.* ¶¶ 17–18.) The only reason given in the complaint for why any of these "failures" violated the internal controls provision was that Oracle knew distributor discounts created a margin of cash from which distributors received payments for their services. The SEC did not allege that Oracle itself knew of the side funds. To the contrary, it alleged that employees of the Indian subsidiary concealed their existence from Oracle, and, as mentioned, that parking funds was a violation of Oracle's internal corporate policies. (*Id.* ¶ 11.)

The DOJ has indicated as part of its settled enforcement actions that, depending on an assessment of corruption risks, it may be appropriate for companies to audit third-party business partners' books to ensure that they have not made improper payments. (*See* Ralph Lauren Non-Prosecution Agreement, *supra*.) *Oracle*, however, raises troubling questions about whether the failure to do so is a per se violation of the FCPA's internal controls provision: Does the SEC now expect every company that uses distributors around the world to audit distributors' margins and their payments to third parties? Is this expectation limited only to companies whose distributors are compensated by retaining the difference between the end-user price and a distributor discount? From a cost-benefit perspective, would this make sense, even in risky countries such as India?

We do not read *Oracle* as an SEC statement that all companies must audit their distributors' margins and distributors' payments to third parties. Significantly, it does not appear that the remedial measures implemented by Oracle itself to address the risk that funds left with distributors could be put to improper uses—which are cited with approval in the SEC's complaint—included auditing distributors' payments on Oracle's behalf. Oracle apparently devised other controls—focused on preventing the creation of side funds altogether—to address the corruption risks presented by its product distribution model in India.

In our view, the true lesson of *Oracle* is not that this particular type of internal control is required, but rather that the internal controls provision is so broad, and the statutory standard of reasonable assurances so subjective, that the SEC has an almost unfettered ability to insist on a settlement, including a civil penalty, at the conclusion of virtually any FCPA investigation. 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. For example, when companies see the SEC pursue an enforcement action over a relatively small amount of improper gifts to employees of a state-controlled telecommunications company, including flowers for its CEO's wife, some may perceive that gifts are such a high-risk area that compliance resources should be diverted to focus on gifts, rather than truly high-risk areas for each company. (*See, e.g.*, SEC Veraz Networks Press Release, *supra*.) Regarding *Oracle* itself, even assuming that Oracle's failure to audit distributors violated the internal controls provision, other companies still must conduct their own risk assessments and cost-benefit analyses before deciding to embark on a program of distributor auditing.

Where Do We Go from Here?

In the post-*Oracle* world, must it be a given that the SEC will pursue an enforcement action, regardless of whether it finds evidence that any foreign official was bribed? To date, seven FCPA enforcement matters including internal controls counts have been announced since *Oracle* and publication of the *FCPA Guide*. Notably, four of these were pursued by the SEC alone, a pattern that may indicate not only the different mens rea requirements for bringing a criminal case, but also genuine attempts by the DOJ to adhere to the principles of reasonableness and proportionality noted in the *FCPA Guide*. As has been noted elsewhere, divergence of opinion between the SEC and DOJ on FCPA enforcement is not unprecedented. (*See, e.g.*, Laurence A. Urgenson, William J. Stuckwisch & Brigham Q. Cannon, *FCPA Anti-Bribery Liability for a Subsidiary's Conduct: Recent Developments Suggest Apparent Split between DOJ and SEC*, Bus. Crimes Bull. (Law Journal Newsletters), Jan. 2013.)

Does the SEC now expect every company that uses distributors around the world to audit distributors' margins and their payments to third parties?

Where can companies look for real-world hints at how to escape an FCPA investigation without the SEC insisting on a settlement? While only one SEC "declination" has been acknowledged publicly, its details provide a few post-*Oracle* lessons. In April 2012, the SEC charged former Morgan Stanley managing director Garth Peterson (in a settled enforcement action) with violating the FCPA's antibribery and internal controls provisions, as well as with investment advisor fraud. (SEC Morgan Stanley Press Release, *supra*.) At the same time, the DOJ charged Peterson with conspiracy to evade Morgan Stanley's internal controls, noting in its press release that Peterson had "conspired with others to circumvent Morgan Stanley's internal controls in order to transfer a multi-million dollar ownership interest in a Shanghai building to himself and a Chinese public official with whom he had a personal friendship." (Press Release, U.S. Dep't of Justice, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA (Apr. 25, 2012), http://tinyurl.com/72jmypq [hereinafter DOJ Morgan Stanley Press Release].) In its press release, the SEC deemed Peterson a "rogue employee" and, in an extremely rare move, publicly announced that Morgan Stanley was not being charged.

The SEC's complaint against Peterson included significant discussion of Morgan Stanley's internal controls. Apart from providing extensive FCPA training, the company:

> had policies to conduct due diligence on its foreign business partners, conducted due diligence on [the bribed foreign official and his employer] before initially conducting business with them, and generally imposed an approval process for payments made in the course of its real estate investments. Both were meant to ensure, among other things, that transactions were conducted in accordance with management's authorization and to prevent improper payments, including the transfer of things of value to officials of foreign governments.

(Complaint at ¶ 23, SEC v. Peterson (*Morgan Stanley*), No. 1:12-cv-02033-JBW (E.D.N.Y. Apr. 25, 2012).)

Praise for Morgan Stanley was not limited to the SEC. In its press release, the DOJ also highlighted the company's controls:

> According to court documents, Morgan Stanley maintained a system of internal controls meant to ensure accountability for its assets and to prevent employees from offering, promising or paying anything of value to foreign government officials. Morgan Stanley's internal policies, which were updated regularly to reflect regulatory developments and specific risks, prohibited bribery and addressed corruption risks associated with the giving of gifts, business entertainment, travel, lodging, meals, charitable contributions and employment. Morgan Stanley frequently trained its employees on its internal policies, the FCPA and other anti-corruption laws. Between 2002 and 2008, Morgan Stanley trained various groups of Asia-based personnel on anti-corruption policies 54 times. During the same period, Morgan Stanley trained Peterson on the FCPA seven times and reminded him to comply with the FCPA at least 35 times. Morgan Stanley's compliance personnel regularly monitored transactions, randomly audited particular employees, transactions and business units, and tested to identify illicit payments. Moreover, Morgan Stanley conducted extensive due diligence on all new business partners and imposed stringent controls on payments made to business partners.

(DOJ Morgan Stanley Press Release, *supra*.)

Reading these public documents, there can be no doubt that the government was trying to send a message that it will reward robust internal controls by declining to bring an enforcement action against a potential corporate defendant in the appropriate case, even when it is able to prove an antibribery charge, as it clearly could based on Garth Peterson's conduct as a Morgan Stanley employee. And there can be no doubt that Morgan Stanley and its counsel gave the government plenty of internal-controls-specific evidence for use in sending this message. Even after discounting Morgan Stanley—on account of the notion that it may represent an attempt to demonstrate a principle, plus the fact that there was an individual defendant whom the SEC could sue in lieu of the company (which is not always true in FCPA matters)—useful takeaways for the post-*Oracle* era can still be gleaned from it.

Takeaways

Recognize the government's subject matter expertise. First, clients and counsel should understand that the government, specifically the DOJ Criminal Division's Fraud Section and SEC Enforcement Division's FCPA Unit, are now fully invested in the compliance business. Day after day, week after week, these prosecutors and enforcement lawyers hear presentations from a wide array of lawyers and compliance professionals. In contrast, individual compliance officers are often buried in the (admittedly all-consuming) details of compliance program design, implementation, and update within their own companies. While, for most of the period of FCPA enforcement, the government was continually playing catch-up in its understanding of compliance practices, the tables have now turned. Companies are at risk of quickly appearing outdated, even when well-resourced and well-intentioned, as the government simply has higher visibility into the state-of-the-art than any counsel or compliance professional can achieve without concerted effort. Continual benchmarking is therefore a vital component of any developed system of internal controls. If the government has seen another company (competitor or not) implement a control that may have prevented the type of alleged conduct for which it is investigating your client, it will want to know (perhaps unfairly) whether your client considered implementing that step and, if not, why not.

Tailor internal controls to company-specific risks. While benchmarking is helpful to understand the state-of-the-art and find potentially effective ways to mitigate risk, each company's internal controls still must be tailored to its particular risks and circumstances. And while studying government enforcement actions can be helpful in understanding the government's views, government allegations that one company's internal controls were insufficient because they lacked a particular element does not mean that every company's internal controls must also include that element to be effective. Embrace the government's acknowledgment in the *FCPA Guide* that the internal controls provision gives companies flexibility to implement a system of internal controls that is appropriate to address their particular needs and circumstances. Tailor FCPA compliance programs to the specific risks presented by the way the business is run. Document the conscious, good-faith decisions that are made as part of the cost-benefit analysis that inevitably must inform the design of a system of internal controls in a world of limited compliance resources.

Start now. It may seem obvious, but whatever your plan of action, do not delay implementation. Change, even incremental change for those with well-established compliance programs, always takes longer than initially anticipated. Counsel and their clients never know when an FCPA matter will have them sitting across the table from the DOJ and SEC. Never was this truer than now, as the post-*Oracle* era coincides with the deployment of the SEC's Office of the Whistleblower and offer of significant financial incentives to potential whistleblowers. (U.S. Sec. & Exch. Comm'n, Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2012 (2012), *available at* http://tinyurl.com/cu8mzjg.)

In any investigation, develop the compliance story. Just as counsel would marshal the facts and evidence to support any other argument, counsel should seek to demonstrate to the government that—notwithstanding alleged foreign bribery or other bad conduct—their client's internal controls were designed to provide reasonable assurances that even employees and agents on the other side of the world would not engage in bribery. In *Morgan Stanley*, details such as the number of times Morgan Stanley employees and agents were trained clearly resonated with the government. Aspects of Morgan Stanley's internal controls that seem removed from the illegal conduct in the case, such as policies and procedures related to giving of gifts, business entertainment, travel, lodging, meals, charitable contributions, and employment, apparently demonstrated to the government that Morgan Stanley took FCPA compliance seriously in designing its internal controls. By telling the story of their client's system of internal controls as a whole, rather than focusing simply on how to defend the area in which there may have been a breakdown, counsel will be better positioned to argue that the internal controls were sufficient, if imperfect, and that the SEC should reward their client for having an effective preexisting system of controls.

Conclusion

The post-*Oracle* world of SEC FCPA internal controls provision enforcement is one of high stakes and uncertain boundaries. When representing a client in a parallel DOJ and SEC FCPA investigation, the SEC's approach to the internal controls provision should not be overlooked, or relegated to an issue to address at the end of the criminal investigation. Rather, counsel should realize that they will face an uphill battle convincing the SEC to decline to bring any action at the end of the day, and plan for that battle now. ■