

Client Alert

Special Matters & Government Investigations Practice Group

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SEC Cracks Down on Charitable Contributions under the FCPA

Best Practices In Light of Recent SEC Enforcement

For the first time, the Securities and Exchange Commission has brought an FCPA enforcement action premised entirely on a one-time charitable contribution.

On September 20, 2016, the SEC announced a settled FCPA enforcement action against Nu Skin Enterprises, Inc. (Nu Skin US) premised on its subsidiary's one-time contribution to a charity associated with a Chinese Communist Party Official. The SEC framed the conduct as a violation of the FCPA's internal controls and books and records provisions.

Conduct at Issue

According to the allegations in the SEC's Order, in 2013 Nu Skin US's Chinese subsidiary was under investigation by a provincial agency and facing RMB 2.8 (approximately \$431,000) in fines for conducting a business without a proper direct-selling license.ⁱ The subsidiary, Nu Skin China, solicited the assistance of a local Communist Party Official and, in exchange for the intervention, offered a RMB 1 million (approximately \$154,000) donation to a charity "associated with" the Official.ⁱⁱ A week later, Nu Skin China made the donation at a public ceremony attended by both the Party Official and a top agency official.ⁱⁱⁱ Nu Skin China asked the agency to drop the action, and was promptly notified by the agency that it would not be charged or fined.^{iv}

In addition to the donation itself, the SEC noted several other aggravating circumstances. Firstly, Nu Skin US had been in the process of obtaining U.S. college recommendation letters for the Party Official's child. Once the investigation arose, Nu Skin China asked Nu Skin US to expedite them (without mention of the investigation), and it did.^v Additionally, Nu Skin US knew of the proposed donation, albeit not of its connection to the pending investigation. Finally, although Nu Skin US had instructed Nu Skin China to include anti-corruption language in the draft donation agreement, it did not follow-up and detect that the language was ultimately removed from the final version.^{vi}

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SEC Findings and Resolution

According to the SEC's Order, Nu Skin US violated the FCPA's accounting provisions.^{vii} It violated the "books and records provision" because its "wholly-owned subsidiary's expenditure authorization form" improperly recorded the payment's purpose as a "donation" rather than "a payment to influence the Party Official to favorably impact the outcome of the AIC investigation."^{viii} Second, making particular note of the "well-known corruption risks in China," the SEC found that Nu Skin US violated the FCPA's "internal controls provision";^{ix} its internal controls, including its subsidiary's due diligence, were inadequate to identify the charity's political ties and ultimately prevent the improper payment.^x

Nu Skin US neither admitted nor denied the allegations, but agreed to a cease-and-desist order and over \$750,000 in disgorgement, civil monetary penalties, and prejudgment interest. In agreeing to settle the action, the SEC considered Nu Skin US's prompt remedial efforts and cooperation with SEC staff.^{xi}

Key Takeaways

The SEC and DOJ have repeatedly cautioned companies regarding the risks of charitable giving. The agencies squarely addressed the issue of charitable giving in the jointly issued FCPA Resource Guide in 2012: "Companies ... cannot use the pretense of charitable contributions as a way to funnel bribes to government officials."^{xii} A parent company's policies and internal controls are "critical" to ensure that each donation its subsidiaries represent "[l]egitimate charitable giving."^{xiii} The DOJ has also published a number of Opinion Releases that reinforce these admonitions.^{xiv}

But historically, the SEC has brought enforcement actions relating to charitable contributions only when there were other violations or repeated donations. Indeed, only one prior action was premised entirely on charitable contributions; brought by the SEC in 2004, it involved a series of contributions carefully structured to avoid detection and made over a period of several years.^{xv} The recent Nu Skin action, which the SEC premised on one payment to a single charity, represents a more aggressive approach.

Notably, the Order states that Nu Skin China recorded the donation in its books and records as a donation. The accounting records were nonetheless inaccurate, the Order suggests, because the payment's true purpose was bribery. Thus, according to the SEC, not only can a single charitable donation by a foreign subsidiary potentially subject a US parent company to FCPA liability because of weak internal controls at the parent, but also because the donation was recorded as a donation in the subsidiary's books (rather than as a bribe).

Parent companies operating subsidiaries and joint ventures in foreign jurisdictions, particularly those with high risks of corruption, must closely monitor charitable and social responsibility donations in those countries.

Internal controls and processes must be robust, including clear written guidance and approval protocols for charitable donations and other uses of company funds. Such protocols should include due diligence on any charity to whom a donation is contemplated in order to ensure the lack of connection to any government officials relevant to the operation of the company or its clients. Companies are also well advised to avoid altogether any charitable donations requested by foreign officials or tied to obtaining or retaining business benefits. Finally, companies should develop clear and comprehensive rules for accounting for charitable donations. Companies should extend these rules and processes to their subsidiaries, and should monitor subsidiaries' compliance with them.

The SEC and DOJ acknowledge that "[l]egitimate charitable giving does not violate the FCPA," and it should be encouraged.^{xvi} But such gifts carry risks, and the SEC's aggressive enforcement action against Nu Skin US serves as a cautionary tale. Companies must implement—and monitor—robust measures to ensure that such giving is not used as a vehicle for bribery.

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ⁱ Order at ¶¶ 6, 9, In the Matter of Nu Skin Enterprises, Inc., No. 3-17556 (S.E.C. Sept. 20, 2016), available at <https://www.sec.gov/litigation/admin/2016/34-78884.pdf> (hereinafter Nu Skin Order). This is not the first time enforcement authorities have focused on direct selling licenses in China. Such permits were a primary focus of the Avon matter. See Complaint at ¶ 4, *United States v. Avon Products, Inc.*, No. 14-cv-9956 (S.D.N.Y. Dec. 17, 2014), available at <https://www.sec.gov/litigation/complaints/2014/comp-pr2014-285.pdf>, and Deferred Prosecution Agreement, *United States v. Avon Products, Inc.*, No. 14-Cr-00828 (S.D.N.Y. Dec. 17, 2014), available at <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2014/12/30/avon-dpa-file-stamped.pdf>.

ⁱⁱ Nu Skin Order at ¶¶ 7-8. The Party Official involved had previously been the AIC provincial head's direct supervisor. *Id.*

ⁱⁱⁱ *Id.* at ¶ 14.

^{iv} *Id.* at ¶¶ 14-15.

^v *Id.* at ¶ 11.

^{vi} *Id.* at ¶ 13 (describing Nu Skin US' recommendation that Nu Skin China contact China-based US counsel about the proposed contribution, and counsel's subsequent recommendation of including anti-corruption language).

^{vii} *Id.* at ¶ 20.

^{viii} *Id.* at ¶¶ 16, 20. The "books and records provision" requires Nu Skin US and its subsidiaries to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the [company]." 15 U.S.C. § 78m(b)(2)(A).

^{ix} Nu Skin Order at ¶ 19, 20. The "internal controls provision" requires Nu Skin US to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" of asset accountability and appropriate recording of transactions. 15 U.S.C. § 78m(b)(2)(B)).

^x Nu Skin Order at ¶¶ 16, 20.

^{xi} See Administrative Summary, *In the Matter of Nu Skin Enterprises, Inc.*, No. 3-17556 (S.E.C. Sept. 20, 2016), available at <https://www.sec.gov/litigation/admin/2016/34-78884-s.pdf>.

^{xii} DOJ & SEC, *A Resource Guide to the Foreign Corrupt Practices Act (2012)* at 16, available at <https://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf> (discussing Schering-Plough prosecution and noting that internal documents revealed this view). The SEC's Nu Skin Order repeatedly cited internal documents as evidence of the intent underlying the donation. See Nu Skin Order at ¶¶ 9, 11, 14.

^{xiii} SEC-DOJ FCPA Resource Guide at 19.

^{xiv} See, e.g., *Microfinancing Grant*, Op. Att'y Gen. No. 10-02 (Jul. 16, 2010) (declining enforcement in light of multi-part due diligence process and unlikelihood of impact to relevant officials); see also *Payment of Medical Expenses*, Op. Att'y Gen. No. 13-01 (Dec. 13, 2013) (declining enforcement due to lack of potential impact on company's business operations).

^{xv} Litigation Release No. 18740 (S.E.C. Jun. 9, 2004), available at <https://www.sec.gov/litigation/litreleases/lr18740.htm>. In 2004, the SEC prosecuted Schering-Plough for approximately \$76,000 in contributions made by its Polish subsidiary to a charitable foundation run by the Director of a government health fund in order to encourage the purchase of Schering-Plough products. The series of thirteen payments over a three-year period were deliberately structured to conceal their corrupt nature. Complaint at ¶ 7, *Securities and Exchange Commission v. Schering-Plough Corp.*, No. 1:04CV00945 (D.D.C. Jun. 9, 2004), available at <https://www.sec.gov/litigation/complaints/comp18740.pdf>. Notably, in 2012 the SEC brought an FCPA enforcement action against Eli Lilly that was partially premised on a series of contributions made by its Polish subsidiary to this same charitable organization, made with the same intent of encouraging the same official's purchase of Eli Lilly products. See Complaint at ¶¶ 7-15, *Securities and Exchange Commission v. Eli Lilly and Company*, No. 1:12-cv-02045 (D.D.C. Dec. 20, 2012), available at <https://www.sec.gov/litigation/complaints/2012/comp-pr2012-273.pdf>. Though subsidiaries in other countries allegedly violated the FCPA with more traditional violations such as gifts, monetary bribes, and use of consultants, charitable contributions were the only violations attributed to the Polish subsidiary.

^{xvi} SEC-DOJ FCPA Resource Guide at 19.