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CAPTAIN MORGAN MAKER SERVED STIFF PENALTY BY SEC FOR FCPA VIOLATIONS

In a July 27, 2011 release, the SEC announced a settlement that required the world's largest spirits company, Diageo PLC ("Diageo"), to pay disgorgement of $11,306,081 plus interest and a $3 million civil penalty for violations of the Foreign Corrupt Practices Act ("FCPA").

Diageo, headquartered in London, is a leading producer and distributor of premium branded alcoholic beverages, including Johnnie Walker, Smirnoff, Captain Morgan, and Guinness. Through various direct and indirect subsidiaries, Diageo maintains operations in more than 180 countries.

Diageo self-disclosed the FCPA violations following an internal investigation in order to take advantage of the leniency provisions in the FCPA. As a result, the settlement took the form of a cease-and-desist order rather than a more restrictive injunctive action, the Department of Justice did not institute additional proceedings against Diageo, and the $3 million dollar civil penalty is smaller than many much-larger penalties that have been imposed in these cases.

According to the SEC's cease-and-desist order found at www.sec.gov/litigation/admin/2011/34-64978.pdf, Diageo paid more than $2.7 million to various government officials in India, Thailand, and South Korea in separate efforts to obtain lucrative sales and tax benefits through its subsidiaries over a period spanning more than six years.

This settlement provides guideposts for the areas in which both compliance committees and management must maintain vigilance to avoid running afoul of the FCPA. These guideposts include:

(i) liability for the activities of subsidiaries, (ii) working with third-party agents and consultants, (iii) the risks of providing gifts and entertainment, (iv) working with "state owned enterprises," and (v) the requirement for transparent books and records.

Acquiring FCPA Liability

Diageo was formed in 1997 through the merger of two existing companies. For the next several years, the company grew through acquiring interests in various foreign subsidiaries. In fact, all three subsidiaries found to have been the cause of Diageo's FCPA violations were companies acquired by Diageo.

The SEC attributed some of the FCPA violations to weak compliance policies exacerbated by rapid expansion through acquiring companies with weak compliance programs.

Third party risks

One of Diageo's subsidiaries reimbursed its third-party promoters and distributors for payments the promoters made to government officials for the purpose of securing label registrations for Diageo's products. They also reimbursed the third parties for payments made to officials to secure import permits and administrative approvals.

The third parties were reimbursed for the payments through debit notes that described the payments as "special rebates" or "incentive for reaching sales targets."

Local Customs – Does Following Create Liability?

Diageo's South Korean subsidiary routinely paid South Korean military officers, many of whom were responsible for procuring liquor. The payments took the form of traditional holiday gifts, known locally as "rice cake" payments, and business development gifts, called "Mokjuksaupbi" payments. Conventional wisdom said that Diageo would have been at a competitive disadvantage if it did not make the payments, but Diageo's subsidiary used fake vendor invoices to pay for the rice cake payments, and it failed to record them in the general ledger. The Mokjuksaupbi payments were likewise recorded in the general ledger as sales and promotion expenses.

Who is a government official?

Diageo's India operations made improper payments to employees of India's government run liquor stores in exchange for increased government sales orders and favorable product placement within the stores. Again, these expenses were deceptively recorded in the ledger. If litigated, Diageo may have been able to mount a defense against these charges on the ground that a liquor store employee is not, under the FCPA, a "government official." Future developments in this area will require close scrutiny.

Vigilance is Imperative

International subsidiaries, third party contractors, and payments according to local custom in international markets do not only present pitfalls for Fortune 500 corporations. Companies of any size who have questions about whether they have acquired FCPA liability, or who have questions about the transparency of the corporate books and records, should contact competent white collar counsel to investigate. As Diageo demonstrates, voluntary disclosure can save significant money.

SUPREME COURT RULES QUI TAM PLAINTIFF MAY NOT BASE FALSE CLAIMS ACT SUIT ON CONTENTS OF FOIA

The Supreme Court established the "public disclosure bar" as an effective tool for corporations to defend against False Claims Act cases. In *Schindler v. U.S. ex. rel. Kirk*, 563 U.S. __ (2011), the Court held that the public disclosure bar contained within the False Claims Act ("FCA") applies to cases premised upon Freedom of Information Act ("FOIA") disclosures.

The Relator in the case, a Vietnam Veteran named Daniel Kirk, alleged that Schindler violated The Vietnam Era Veterans Readjustment Assistance Act's ("VEVRAA"), reporting requirements by failing to file certain required VETS-100 reports and included false information in those it did file. Kirk supported his claims with the United States Department of Labor's ("DOL") response to three FOIA requests filed by his wife, Linda Kirk.

In the opinion, Justice Thomas held that the DOL FOIA disclosures are "reports," within the public disclosure bar clause from the False Claims Act:

> "No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information." 31 U.S.C. §3730(e)(4)(A)(footnote omitted).

The Court goes even further and cites its decision in *Graham County*, 559 U.S. at ___, n.6 (slip op., at 6, n.6), to hold that §3730(e)(4)(A) is not even limited to the cited congressional, administrative, or GAO reports, and that these adjectives only serve to say that a "report" must be governmental for the bar to apply. *Schindler*, (slip op. at 7).

Further, any records the agency produces along with its written FOIA response are part of that response, "just as if they had been reproduced as an appendix to a printed report." (Op. at 9, *citing Mistick*, 186 F.3d at 334, n.5).

In case corporations seek to insulate themselves from liability under the FCA by making FOIA requests for incriminating documents, the Court notes that a FOIA response may not be tainted forever. A Relator may have an argument that his claim is not "based upon" the information contained in the FOIA disclosure. The federal circuits are split on this issue, and the Court has not yet elected to settle the matter. *See, e.g., Glaser v. Wound Care Consultants, Inc.*, 570 F.3d 907, 915 (CA7 2009)(describing the split in authority). The Court points out that a Relator may also qualify for the "original source" exception. (Op. at 12).

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For the time being, corporations facing liability under the FCA in cases brought by Relators who have based their complaints upon information obtained in response to FOIA requests have a good avenue by which to seek dismissal pursuant to the public disclosure bar. Competent white-collar counsel should be consulted to evaluate the availability of this remedy.