Why You Should Be Alarmed By the ADM FCPA Enforcement Action

BY MIKE KOEHLER

Like all statutes, the Foreign Corrupt Practices Act has specific elements that must be met in order for there to be a violation. However, with increasing frequency in this new era of FCPA enforcement, it appears that the Department of Justice and the Securities and Exchange Commission have transformed FCPA enforcement into a free-for-all in which any conduct the enforcement agencies find objectionable is fair game to extract a multimillion-dollar settlement from a risk-averse corporation.

A case in point is the recent $54 million FCPA enforcement action against Archer Daniels Midland Co. (ADM) and related entities.

Introduction

After discussing the principal features of this enforcement action—namely that ADM and its shareholders were victims of a corrupt Ukraine government—this article highlights why anyone who values the rule of law should be alarmed by the ADM enforcement action.

The ADM enforcement action (the 17th largest settlement amount in FCPA history) involved a $17.8 million DOJ enforcement action and a $36.5 million SEC enforcement action focused on value-added tax (VAT) refunds in Ukraine. In the words of the DOJ, “the Ukrainian government did not have the money to pay VAT refunds that it owed to companies that sold Ukrainian goods outside of Ukraine.” Likewise, the SEC acknowledged that “the Ukrainian government determined to delay paying the VAT refunds owed or did not make any refund payments at all.” Accordingly, Alfred C. Toepfer International (Ukraine) Ltd. (ACTI Ukraine), an indirectly owned subsidiary of ADM whose operations were largely independent from ADM’s operations, accumulated tens of millions in receivables for VAT refunds.

Before detailing the DOJ and SEC’s allegations as to how ACTI Ukraine sought to obtain the VAT refunds it was owed by the Ukrainian government, it is important to understand how the Ukraine government’s retention

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\[1\] 09 WCR 6 (1/10/14).
of VAT refunds was a “lucrative aspect of Ukraine’s endemic corruption.”

For instance, a report from the Office of the U.S. Trade Representative said, “Delays in the payment of VAT refunds to exporters [has] been a problem” and that “some companies received reduced refunds or were refused refunds for arbitrary reasons.” The report specifically noted, “U.S. grain traders in particular claim several hundred million dollars in VAT arrears” and that “the [Ukraine State Tax Administration] instituted an automated system for VAT refunds, but non-transparent criteria have prevented most firms from participating in the system and receiving their refunds.”

Likewise, the agribusiness working group of the U.S.-Ukraine Business Council in Washington noted:

VAT tax refunds due businesses are presently paid by the government of Ukraine with lag times that range from months to over a year, and in some cases with an ultimate bureaucratic denial of valid refund claims. The size of the refunds due private businesses and the time it takes to pay them in Ukraine . . . represents the worst record in the world by any government.

**ACTI Ukraine Enforcement Action**

It is against this relevant backdrop that the conduct at issue in the ADM enforcement action occurred. According to the DOJ, “in order to obtain VAT refunds from the Ukrainian government, ACTI Ukraine, with the help of its affiliate, Alfred C. Toepfer International G.m.b.H. (ACTI Hamburg) [likewise an indirect subsidiary of ADM], paid third party vendors to pass on nearly all of that money as bribes to government officials . . . in exchange for those officials’ assistance in obtaining VAT refunds for and on behalf of ACTI-Ukraine.”

The DOJ alleged that the “VAT refunds gave ACTI Ukraine a business advantage resulting in a benefit to ACTI Ukraine and ACTI Hamburg of roughly $41 million.” The SEC alleged that the payments allowed ACTI Ukraine to obtain the “VAT refunds earlier than they otherwise would have” and that “getting these VAT refunds earlier—before Ukraine endured a brief period of hyperinflation—gave ACTI Ukraine a business advantage resulting in a benefit to ADM of roughly $33 million.”

Based on these allegations, the DOJ charged ACTI Ukraine with conspiracy to violate the FCPA’s anti-bribery provisions.

The FCPA’s anti-bribery provisions of course have specific elements including corrupt intent and obtain or retain business. Moreover, even if these statutory elements have been met, the DOJ has the burden of rebutting the FCPA’s facilitation-payments exception.

While it may seem old-fashioned to do so, this article does something rarely seen in this new era of corporate FCPA enforcement. It analyzes actual legal authority relevant to these elements and exception for the simple reason that the rule of law demands such an analysis.

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9 359 F.3d 738 (5th Cir. 2004).
tion, the final step in analyzing the FCPA’s anti-bribery provisions is determining whether the FCPA’s facilitating-payment exception applies.

The FCPA’s anti-bribery provisions “shall not apply to any facilitating or expediting payment to a foreign official . . . the purpose of which is to expedite or to secure the performance of a routine government action by a foreign official.” In a case of first impression in an FCPA enforcement action in 2012, a judge rejected the SEC’s position that a defendant had the burden of pleading the inapplicability of the exception.12 Rather, the judge concluded that the enforcement agency “must bear the burden of negating the facilitating payments exception” and that the “exception is best understood as a threshold requirement to pleading that a defendant acted ‘corruptly.’”

As with other aspects of the ATC I Ukraine information that are difficult to understand when viewed through the context of actual FCPA legal authority, it is also difficult to see how the DOJ would have satisfied this pleading burden given that the DOJ itself alleged that VAT refunds were “owed” to ADM entities.

Richard Grime, a former high-ranking SEC FCPA enforcement attorney, stated prior to the ADM action that the “fact that the FCPA’s twin enforcement agencies have treated certain payments as prohibited despite their possible categorization as facilitating payments does not mean that a federal court would agree.”

In short, it is difficult to square existing legal authority regarding the FCPA’s anti-bribery provisions with the facts alleged in the ATC I Ukraine information, and anyone who values the rule of law should be alarmed by it.

ADM Enforcement Action

In addition to the ACTI Ukraine criminal information and plea agreement, the DOJ also entered into a non-prosecution agreement with ADM based principally on the same Ukraine allegations.13 In addition, the SEC brought a settled civil complaint against ADM based on the same Ukraine allegations. The SEC complaint charged ADM with civil violations of the FCPA’s books-and-records and internal-controls provisions. Because the DOJ’s resolution vehicle was an NPA, it did not charge any technical violations of law. However, it does reference how the DOJ “will not criminally prosecute ADM . . . for any crimes . . . related to violations of the internal-controls provisions of the FCPA and arising from or related to improper payments by the Company’s subsidiaries, affiliates, or joint ventures.”

Legal Authority. This portion of the article analyzes actual legal authority concerning the FCPA’s internal-controls provisions relevant to ADM’s alleged legal liability. As highlighted below, the principal basis for ADM’s alleged liability is that ADM failed to prevent alleged bribes at its indirect subsidiaries.

With the typical after-the-fact perfect hindsight with which the SEC tends to view conduct that took place many years ago, the commission alleged that “ACTI’s conduct went unchecked by ADM” and that “ADM’s anti-bribery compliance controls in existence at the time were insufficient in that they did not deter and detect these payments.” The SEC further stated, “ADM’s anti-corruption policies and procedures relating to ACTI were decentralized and did not prevent improper payments by ACTI to third-party vendors in the Ukraine or ensure that these transactions were properly recorded by ACTI.” The SEC’s release also states that ADM failed “to prevent illicit payments made by foreign subsidiaries to Ukrainian government officials in violation of the FCPA.” Likewise, the DOJ asserted that ADM “failed to implement sufficient policies and procedures to prevent the bribe payments.”

Although the ADM action was certainly not the first to assert a standard akin to issuer strict liability for the alleged activities of its subsidiaries, the enforcement agencies’ invocation of a “failure to prevent” standard is alarming because such a standard does not even exist in the FCPA and is inconsistent with actual legal authority.

Just as important, such a standard is inconsistent with enforcement agency guidance relevant to the internal-controls provisions.

As to the FCPA’s internal-controls provisions, while it again may seem old-fashioned, the rule of law likewise demands an analysis of actual legal authority. The internal-controls provisions are specifically qualified through concepts of reasonableness and good faith. This statutory standard is consistent with congressional intent in enacting the provisions. Relevant legislative history states:

While management should observe every reasonable prudence in satisfying the objectives called for [in the books-and-records and internal-controls provisions], . . . management must necessarily estimate and evaluate the cost/benefit relationships to the steps to be taken in fulfillment of its responsibilities . . . . The size of the business, diversity of operations, degree of centralization of financial and operating management, amount of contact by top management with day-to-day operations, and numerous other circumstances are factors which management must consider in establishing and maintaining an internal accounting controls system.14

Judicial decisions are also another form of actual legal authority concerning the internal-controls provisions. The only judicial decision to directly address the substance of the internal-controls provisions states, in pertinent part, as follows:

The definition of accounting controls does comprehend reasonable, but not absolute, assurances that the objectives expressed in it will be accomplished by the system. The concept of “reasonable assurances” contained in [the internal control provisions] recognizes that the costs of internal controls should not exceed the benefits expected to be derived. It

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13 The NPA’s statement of facts also contains additional allegations regarding “Conduct Relating to Venezuela,” including how a “high level executive” of an ADM joint venture circumvented ADM’s internal controls in making alleged payments to alleged Venezuela officials as well as engaged in self-dealing. Given the terms of the NPA, this alleged Venezuela conduct did not factor into the $17.8 million DOJ settlement amount.
does not appear that either the SEC or Congress, which adopted the SEC’s recommendations, 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 as they consider the institution of accounting controls 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.\textsuperscript{15}

In addition, various courts have held—in the context of civil derivative actions in which shareholders seek to hold company directors liable for breach of fiduciary duties due to the company’s alleged FCPA violations—that just because improper conduct allegedly occurred somewhere within a corporate hierarchy does not mean that internal controls must have been deficient.\textsuperscript{16}

**Enforcement Agency Guidance.** The “failure to prevent” standard advanced in the ADM enforcement action not only is alarming when measured against actual legal authority but is also against the enforcement agencies’ own guidance concerning the internal controls provisions.

The SEC’s most extensive guidance on the internal-controls provisions states, in pertinent part, as follows:

- **The Act does not mandate any particular kind of internal controls system.** The test is whether a system, taken as a whole, reasonably meets the statute’s specified objectives. “Reasonableness,” a familiar legal concept, depends on an evaluation of all the facts and circumstances.

- **Private sector decisions implementing these statutory objectives are business decisions.** And, reasonable business decisions should be afforded deference. This means that the issuer need not always select the best or the most effective control measure. However, the one selected must be reasonable under all the circumstances.

- **The accounting provisions’ principal objective is to reaching knowing or reckless conduct.**

- **Inherent in this concept of reasonableness is a toleration of deviations from the absolute.** One measure of the reasonableness of a system relates to whether the expected benefits from improving it would be significantly greater than the anticipated costs of doing so. Thousands of dollars ordinarily should not be spent conserving hundreds. Further, not every procedure which may be individually cost-justifiable need be implemented; the Act allows a range of reasonable judgments.

- **The test of a company’s internal control system is not whether occasional failings can occur.** Those will happen in the most ideally managed company. But, an adequate system of internal controls means that, when such breaches do arise, they will be isolated rather than systemic, and they will be subject to a reasonable likelihood of being uncovered in a timely manner and then remedied promptly. Barring, of course, the participation or complicity of senior company officials in the deed, when discovery and correction expeditiously follow, no failing in the company’s internal accounting system would have existed. To the contrary, routine discovery and correction would evidence its effectiveness.\textsuperscript{17}

While there is reference in the ADM enforcement actions to certain ADM tax professionals having knowledge of ACTI Ukraine’s VAT refund struggles, this is hardly surprising and does not suggest participation or complicity of senior company officials in the alleged bribe payments. Indeed, the allegations suggest that ADM executives frequently questioned ACTI Ukraine and ACTI Hamburg about the VAT refunds and the SEC alleged that ACTI Hamburg and ACTI Ukraine “structured payments to avoid detection, and created fictitious insurance contracts to hide from ADM and others the payments to third-parties to secure VAT refunds in Ukraine.”

In short, legal authority—and even enforcement agency guidance—regarding the FCPA’s internal-control provisions stand for the following: Internal controls are not held to a standard of absolute assurances, inherent in the concept of reasonableness if a toleration of deviations from the absolute, and occasional failings may occur in even the most ideally managed company. It is difficult to square this authority and information with the facts alleged in the ADM enforcement action, and anyone who values the rule of law should be alarmed by it.

**Uncharged Bribery Disgorgement**

Wholly apart from the internal controls theory of enforcement in the ADM enforcement action, it is also alarming that the SEC’s $36.4 million settlement amount consisted entirely of disgorgement and prejudgment interest even though the SEC did not charge ADM with violating the FCPA’s anti-bribery provisions. This is yet another example of what has been called no-charged bribery disgorgement.

Paul Berger, a former associate director of the SEC’s Division of Enforcement, has been one of the more vocal critics of this typical SEC resolution feature in corporate FCPA enforcement actions. Berger has stated:

Settlements 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. . . . “[N]o-charged bribery disgorgement” settlements appear designed to inflict punishment rather than achieve the goals of equity. . . . Given the bedrock principle that a court’s equitable power to order such disgorgement goes only as far as the scope of the violation, it is difficult to determine how a court could lawfully allow disgorgement of profits for uncharged

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\textsuperscript{17} SEC Release No. 17500 (Jan. 29, 1981).
violations without the remedy crossing the line into “punishment” for the violations actually charged.\(^\text{18}\)

The SEC claims that its FCPA enforcement program is designed, in part, to “protect investors.”\(^\text{19}\) It is difficult to see how this mission was accomplished in the ADM enforcement action by requiring ADM, or more accurately its shareholders, to disgorge approximately $36 million in money that it was legitimately owed in VAT refunds by the Ukrainian government.

In this regard, you might recall a Forbes article in 2010 titled “The Bribery Racket,” which observed that “companies can find themselves getting extorted in foreign lands, only to get extorted again by Washington.”\(^\text{20}\)

**Why Settle?**

So if the ADM enforcement action was so alarming, why did the company resolve its alleged FCPA scrutiny for $56 million? As highlighted in my article “The Façade of FCPA Enforcement,”\(^\text{21}\), which was cited by former Attorney General Michael Mukasey in congressional testimony,\(^\text{22}\) because of the “carrots” and “sticks” relevant to resolving a government enforcement action, FCPA defendants are often nudged to accept resolution vehicles notwithstanding the enforcement agencies’ untested and dubious enforcement theories or the existence of valid and legitimate defenses. Settlement of a corporate FCPA enforcement action does not necessarily reflect the triumph of one party’s legal position, but rather it reflects a risk-based decision primarily grounded in issues other than facts or the law.

Consider the following. If ADM wanted to put the enforcement agencies to their burdens of proof, it would have required the company to first be criminally indicted by the DOJ or face long, protracted civil litigation with the SEC. If either route were chosen, ADM’s stock price would surely have fallen. Even if the drop were small—say 3 percent—and even if short-lived, the hit to ADM’s market capitalization, an important data point for investors and an important metric by which a business manager’s performance is judged, would have been approximately $850 million.\(^\text{23}\) Compared to this figure, resolving an FCPA enforcement action for approximately $56 million seems like a rationale corporate decision in the best interest of shareholders.

Yet what are the long-term effects of ADM’s decision, not just to the company, but other business organizations subject to increasingly aggressive FCPA enforcement theories who are trying to compete in good faith in the global marketplace. In the words of Joseph Covington, the DOJ’s former FCPA unit chief, these organizations “can’t help but confront corrupt officials—as customers, regulator and adjudicators—and confront them often.”\(^\text{24}\)

As former Attorney General Alberto Gonzales rightly noted:

In an ironic twist, the more that American companies elect to settle and not force the DOJ to defend its aggressive interpretation of the [FCPA], the more aggressive DOJ has become in its interpretation of the law and its prosecution decisions.\(^\text{25}\)

In this regard, the alarming ADM enforcement action should serve as a reminder that the business community is, at least in part, responsible for the current aggressive FCPA enforcement climate. Indeed, as Homer Moyer, a dean of the FCPA bar, recently observed:

One reality is the enforcement agencies’ [FCPA] views on issues and enforcement policies, positions on which they are rarely challenged in court. The other is what knowledgeable counsel believe the government could sustain in court, should their interpretations or positions be challenged. The two may not be the same. The operative rules of the game are the agencies’ views unless a company is prepared to go to court or to mount a serious challenge within the agencies.\(^\text{26}\)

**Conclusion**

There are many who cheer more FCPA enforcement regardless of the enforcement theories. For these cheerleaders, there is much to cheer in the ADM enforcement action, and its $54 million settlement amount will be blindly inserted into FCPA enforcement statistics and trotted out at every available opportunity to demonstrate how the U.S. is the leader in anti-bribery enforcement.

Yet for those who value the rule of law, there is much to lament in the ADM enforcement action. In 2010, then-Deputy Assistant Attorney General Lanny A. Breuer delivered a speech before the Council of Foreign Relations titled “International Criminal Law Enforcement: Rule of Law, Anti-Corruption and Beyond.”\(^\text{27}\) As suggested by the title of the speech, Breuer spoke about FCPA enforcement and how the increase in FCPA enforcement was consistent with the U.S.’s global approach to promote the rule of law. Breuer began his speech by asking two rhetorical questions:

- Is the rule of law more than just a “catchphrase?”
- Does the rule of law have any real meaning?

These are great questions in the aftermath of the ADM enforcement action.

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\(^{20}\) Nathan Vardi, The Bribery Racket, Forbes (June 7, 2010).


\(^{23}\) http://finance.yahoo.com/q?s=ADM.

\(^{24}\) FCPA Professor, Former DOJ FCPA Chief Supports FCPA Compliance Defense (Oct. 4, 2011).

\(^{25}\) FCPA Professor, Add Alberto Gonzales To The List Of Former High-Ranking DOJ Officials Who Support An FCPA Compliance Defense (Sept. 11, 2012).
