

Board Members and *Prudent Discharge* of Duties under the FCPA

Monday's FCPA Blog post wrote about what it called a "compliance donnybrook" inside the company China Northeast Petroleum. The facts of this melee are straight-forward, in July, the head of the Board of Director's Audit Committee Robert Bruce, communicated to his fellow directors that he believed the company needed an investigation to make sure it had not violated the Foreign Corrupt Practices Act's (FCPA) anti-bribery provisions and did so in a letter detailing his reasons for making this request. As reported by the FCPA Blog, Mr. Bruce stated, in part "I strongly believe that substantial additional investigation is required in order for the Company and/or the members of the board to be confident that . . . the Company has not made payments to government officials as proscribed by the U.S. Foreign Corrupt Practices Act."

The Chairman of the Board of Directors of China Northeast Petroleum, Mr. Edward Rule, responded declining this request for a FCPA investigation, which Mr. Bruce had suggested be led by an outside law firm with a strong FCPA background. Mr. Rule noted that such an investigation "could last as long as a full year and cost the Company as much as several millions of dollars" and could even lead to the delisting the company from the NYSE AMEX. Mr. Rule ended his letter by noting "the course of action you recommend that the Board pursue seems at odds with the *prudent discharge* of duties to the shareholders".

This final sentence caught the attention of the FCPA Compliance and Ethics Blog. What are the obligations of a Board member regarding the FCPA? Are the obligations of the Audit Committee under the FCPA at odds with a director's "*prudent discharge* of duties to shareholders"? Do the words *prudent discharge* even appear anywhere in the FCPA? My search into answers for the first two questions began with a recent ethics-point webinar, entitled "Reporting to the Board on Your Compliance Program: New Guidance and Good Practices", where attorneys Rebecca Walker and Jeffery Kaplan, of the law firm of Kaplan and Walker, explored these and other issues.

Mr. Kaplan pointed to the US Sentencing Guidelines and Department of Justice (DOJ) Prosecution Standards for guidance as to the obligations of a company's Board regarding FCPA compliance. Under the US Sentencing Guidelines, Ms. Walker said that the Board must exercise reasonable oversight on the effectiveness of a company's compliance program. Ms. Walker said that the DOJ Prosecution Standards posed the following queries: (1) Do the Directors exercise independent review of a company's compliance program? and (2) Are Directors provided information sufficient to enable the exercise of independent judgment?

As to the specific role of 'Best Practices' in the area of general compliance and ethics, Ms. Walker looked to Delaware corporate law for guidance. She cited to the case of *Stone v. Ritter* for the proposition that "a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate exists." From the case of *In re Walt*

Disney Company Derivative Litigation, she drew the principle that directors should follow the best practices in the area of ethics and compliance.

In a recent Compliance Week article, Melissa Aguilar examined the duties of Board members regarding FCPA compliance. The conclusions of several of the FCPA experts that Ms. Aguilar interviewed for the article were that companies which have not yet had any FCPA issues rise up to the Board level are usually the ones which are the most at risk. Albert Vondra, a partner with PricewaterhouseCoopers stated that such companies “don’t have the incentive to spend the resources or take the rigorous approach to their anti-compliance programs. Their attitude is, ‘We’ve got it covered,’ but they don’t”. Richard Cassin, managing partner of Cassin Law, stated that there must be written records demonstrating that the audit committee and that the board members asked questions and received answers regarding FCPA compliance issues. Such documentation demonstrates the Board members have “fulfilled their fiduciary obligations,” Cassin says.

Board failure to heed this warning can lead to serious consequences. David Stuart, a senior attorney with Cravath Swaine & Moore, noted that FCPA compliance issues can lead to personal liability for directors, as both the Securities and Exchange Commission (SEC) and DOJ have been “very vocal about their interest in identifying the highest-level individuals within the organization who are responsible for the tone, culture, or weak internal controls that may contribute to, or at least fail to prevent, bribery and corruption”. He added that based upon the SEC’s enforcement action against two senior executives at Nature’s Sunshine, “Under certain circumstances, I could see the SEC invoking the same provisions against audit committee members—for instance, for failing to oversee implementation of a compliance program to mitigate risk of bribery”.

What does all of this mean for Messers Bruce, Rule and the rest of the Board members of China Northeast Petroleum? It should mean quite a bit. The DOJ has made it clear that it expects ‘best practices’ when it comes to FCPA compliance. In the case of China Northeast Petroleum, the head of the Board’s Audit Committee has requested an independent FCPA compliance investigation, to be effected by an outside firm. The Chairman of the Board of Directors has rejected this request because (1) it might take up to a year and (2) it might cost too much money AND fulfilling its FCPA obligation “seems at odds with the *prudent discharge* of duties to the shareholders”. The head of the Audit Committee resigned over this rejection.

Alas, there is no reference to *prudent discharge* in the FCPA itself. However, if I were a remaining member of the Board of China Northeast Petroleum, I might well think more than twice about my *prudent discharge* of duties to the shareholders as both the DOJ and SEC now might well wish to look into this matter under a Board’s *prudent discharge* of duties under the FCPA.

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