

Charitable Donations And FCPA Risks: Lessons From Nu Skin

Law360, New York (September 30, 2016, 12:41 PM EDT) -- On Sept. 20, Utah-based cosmetic and nutritional products manufacturer Nu Skin Enterprises Inc. (Nu Skin US) agreed to pay more than \$765,000 to resolve U.S. Securities and Exchange Commission claims that it violated the books-and-records and internal controls provisions of the Foreign Corrupt Practices Act in connection with a charitable donation made by its Chinese subsidiary (Nu Skin China).

The enforcement action is a cautionary tale for companies and organizations that make charitable donations in high-risk countries, and demonstrates that donors are expected to make meaningful efforts to ensure that their contributions are not only paid to legitimate entities, but also provided for legitimate purposes.

Background

In 2013, a provincial branch of China's Administration of Industry and Commerce informed Nu Skin China that it planned to charge the company and members of its sales staff with violating China's direct selling laws and impose a fine in the amount amount of RMB 2.8 million (approximately \$431,000). In response, "[s]enior personnel of Nu Skin China ... made a decision to request that [a Chinese Communist] Party Official personally intervene in the AIC matter in return for Nu Skin China making a One Million RMB [\$154,000] donation to [a] charity identified by the Party Official." [1]

While the party official proposed a charity that was not yet operating in the region, "[t]he Party Official ... was associated with the entity that was [ultimately] responsible for establishing the charity in the province." [2]

A public donation ceremony was held in the province to recognize the donation, and "the Party Official gave a speech [at the ceremony] praising Nu Skin China" for the contribution. [3] Two days later, the AIC notified the company of its final decision not to charge or seek a fine. The SEC noted that the provincial head of the AIC had previously reported to the party official.

In its cease-and-desist order, the SEC accused Nu Skin China of using the charity project "to affect the outcome of the [AIC] investigation." [4] The SEC cited several company emails in support of its allegations, including an internal email stating that Nu Skin China wanted to "donate some money



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instead of [paying] a fine.”[5] Another internal email cautioned that the party official’s intervention was “crucial for us to settle [the AIC investigation] peacefully.”[6]

The SEC cited efforts by Nu Skin China and Nu Skin US to secure college recommendation letters for the party official’s child as “further indicia of the improper purpose for the payment to the charity.”[7] While the party official had asked Nu Skin China to help obtain the college recommendation letters prior to the start of the AIC investigation, internal emails suggest that Nu Skin China and Nu Skin US made the party official’s request a “top priority” after requesting his assistance.[8] NU Skin US subsequently advised Nu Skin China that it “secured an agreement from an influential U.S. person to write the college recommendation letters for the Party Official’s child.”[9]

Due Diligence Deficiencies

Prior to making its charitable donation, Nu Skin China advised Nu Skin US of its intention to donate money to the organization recommended by the party official. At the request of Nu Skin US, the Chinese subsidiary consulted “US legal counsel based in China to ensure that the donation complied with the FCPA.”[10] While legal counsel recommended that Nu Skin China include anti-corruption compliance language in the written donation agreement, and the language was inserted into the draft contract, it was ultimately removed from the final, executed version.[11] According to the SEC, Nu Skin US was not aware that the anti-corruption compliance provision had been removed and was not told about the link between the proposed donation and the pending AIC enforcement action.

Although Nu Skin US identified an FCPA risk and brought it to the attention of outside counsel, the SEC faulted the company for failing to “ensure that adequate due diligence was conducted by Nu Skin China with respect to charitable donations to identify links to government or political party officials and to prevent payments intended to improperly influence such persons in violation of the company’s anticorruption policy and the FCPA.”[12] The SEC explained that “given the well-known corruption risks in China,” the company should have conducted additional due diligence to ensure not only that the payment was being made to a legitimate entity, but also that it was being done with proper intentions.

Alleged Violations

While Nu Skin US neither admitted nor denied the allegations in the cease-and-desist order, the SEC accused the company of violating two provisions of the FCPA: (1) the internal accounting controls provision; and (2) the record-keeping provision.[13] According to the SEC, Nu Skin US violated the internal accounting controls provision because it did not devise and maintain a reasonable system of internal controls over its Chinese subsidiary’s operations, including its charitable activities.[14] The SEC claimed that Nu Skin US violated the FCPA’s record-keeping provision because “the purpose of the payment to the charity was inaccurately and/or unfairly described [in an expenditure authorization form] as a donation rather than an improper payment to obtain the Party Official’s influence.”[15]

Lessons Learned and Risk Mitigation Strategies

When making a charitable donation, companies must not only ensure that the recipients of such donations are bona fide charitable organizations, but also that the donations are being made for legitimate purposes. Before making or authorizing any donations — especially sizable contributions to organizations located in high-risk jurisdictions — companies should develop and implement due diligence protocols that answer the following questions:

1. How was the proposed donee identified?
2. Why was the proposed donee selected?
3. What is the purpose of the donation?
4. Does the proposed donee have any connections to government officials?
5. Will the donation be made to a verified account?
6. Could the donation give rise to the appearance of impropriety?
7. Does the timing of the donation seem tied to any pending or anticipated government actions that could impact the company, such as enforcement actions, investigations, product registrations, regulatory approvals or license requests?

U.S. regulators have warned that companies cannot use “the pretense of charitable contributions” to corruptly influence government officials and have advised companies to make reasonable efforts to ensure that their charitable initiatives are not abused.[16]

Any “red flags” identified during the due diligence process must be evaluated and addressed. Evidence suggesting an attempt to gain an improper benefit or business advantage is a red flag, as is any link between the proposed donee and a government official. A failure to investigate and address such risks could be perceived as an internal controls deficiency that could subject a donor to FCPA liability.

In addition to conducting due diligence on proposed donees, U.S. companies should require that all arrangements to donate money to organizations located outside of the United States be memorialized in writing and subject to the approval of legal or compliance counsel prior to execution. While it is unlikely that the anti-corruption compliance provision recommended by Nu Skin China’s outside counsel probably would not have insulated Nu Skin US from FCPA liability given its internal control deficiencies, U.S. regulators expect the inclusion of such provisions in contracts. The failure to include an anti-corruption compliance provision could be interpreted as an internal controls issue, and a request by a recipient organization to remove such a provision should be treated as a red flag.

Additional controls — including anti-corruption compliance certifications, contract provisions restricting the use of donated funds, and ongoing monitoring of the charitable organization’s activities — can help companies further mitigate the FCPA risks generated by charitable giving. These measures are cited in the U.S. Department of Justice’s opinion releases concerning charitable giving and can act as additional safeguards in risky situations.[17]

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[1] In re Nu Skin Enters. Inc., SEC Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order at ¶ 10 (Sept. 20, 2016) (hereinafter, Cease-and-Desist Order).

[2] Id. at ¶ 8.

[3] Id. at ¶ 14.

[4] Id. at ¶ 8.

[5] Id. at ¶ 9.

[6] Id. at 14.

[7] Id. at 11.

[8] Id.

[9] Id.

[10] Id. at ¶ 13.

[11] Id. at ¶ 16.

[12] Id.

[13] The FCPA's internal controls and recordkeeping provisions were incorporated into Sections 13(b)(2)(A) and (B) of the amended Securities Exchange Act of 1934.

[14] Cease-and-Desist Order at ¶ 16.

[15] Id. at ¶ 20.

[16] U.S. Dep't of Justice and Sec. & Exch. Comm'n, A Resource Guide to the US Foreign Corrupt Practices Act 16 (Nov. 14, 2012).

[17] See U.S. Dep't of Justice, Opinion Release Nos. 95-01 (Jan. 11, 1995), 97-02 (Nov. 5, 1997), and 06-01 (Oct. 16, 2006).