

Smith & Wesson Holstered by the SEC Over FCPA Violations: Lessons Learned

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Smith & Wesson, the iconic American firearms manufacturer, settled a case on July 28, 2014, with the Securities and Exchange Commission (“SEC”) for multiple violations of the Foreign Corrupt Practices Act (“FCPA”). Fortunately for the rest of us, the case provides helpful guidance about what not to do and how to respond when FCPA violations are uncovered. As noted in a [prior alert](#), making sure you are compliant now, before there is a problem, can be the difference between devastating penalties and avoiding charges altogether. Similarly, the manner in which a company reacts to FCPA violations can be equally significant, as the Smith & Wesson case demonstrates. If your business is considering conducting business overseas or already does so you need to ensure you are FCPA compliant, regardless of your business size.

The case against Smith & Wesson arose out of the company beginning efforts in 2007 to expand its business into international markets. This led to what the SEC described as “a pervasive practice of making, authorizing and offering improper payments to foreign government officials as a means of obtaining or retaining international business.” This conduct included attempts to win contracts with foreign governmental entities by making improper payments to third party agents for the purpose of bribing government officials. The improper payments, along with the provision of firearms as gifts, were specifically authorized by the company’s Vice President of International Sales and its Regional Director of International Sales. The company’s illegal payments were successful in Pakistan where the company secured a contract with a Pakistani police department after providing guns valued at more than \$11,000 and additional cash payments. The Pakistani contract resulted in Smith & Wesson selling 548 pistols to the police department and earning a profit of \$107,852. Additional illegal payments were made in attempt to garner contracts with governmental entities in Indonesia, Nepal, Bangladesh, and Turkey, and though ultimately unsuccessful the attempts themselves are violations of the FCPA.

In addition to the illegal payments, Smith & Wesson was cited for not utilizing anti-corruption protocols as it sought to expand its business into foreign high risk markets. In particular, the SEC detailed that the company failed to:

- 1) Design and implement (a) a system of internal controls or (b) an appropriate FCPA compliance program reasonably designed to address the increased risks of its new business model;
- 2) Perform any anti-corruption risk assessment;
- 3) Conduct due diligence of its third-party agents regardless of the perceived level of corruption in the country in which Smith & Wesson was seeking to do business;
- 4) Devise adequate policies and procedures for commission payments;
- 5) Provide oversight of the authority to conduct the company’s international business by placing almost complete authority in the Vice President of International Sales including the sole ability to approve most commissions; and
- 6) Implement adequate FCPA policies and procedures, and FCPA-related training and supervision.

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For these failures, the SEC asserted, and Smith & Wesson agreed, that the company violated the anti-bribery, books and records, and internal controls provisions of the FCPA. As a result, Smith & Wesson was required to disgorge the profits of \$107,852 from the Pakistani contract, pay \$21,040 in prejudgment interest, and pay a civil monetary penalty of \$1,906,000, for a total amount of \$2,034,892.

It was Smith & Wesson's response to these failures, though, that appears to have made an equally profound impression on the SEC. Indeed, the SEC indicated that in coming to this agreement with the company it "considered the remedial acts promptly undertaken by [Smith & Wesson] and cooperation afforded the [SEC] staff." The prompt remedial acts for which Smith & Wesson was praised included:

- 1) Conducting an internal investigation;
- 2) Terminating its entire international sales staff;
- 3) Terminating pending international sales transactions;
- 4) Re-evaluating the markets in which it sought international sales;
- 5) Implementing a series of significant measures to improve its internal controls and compliance processes, including:
 - a. implementing new internal audit procedures to identify FCPA issues;
 - b. creating more robust controls on payments, gifts, and other transactions in connection with international business activity;
 - c. enhancing its FCPA compliance policies and procedures; and
 - d. creating a Business Ethics and Compliance Committee.

Additionally, the company has affirmative reporting obligations to update the SEC on the progress of its continued compliance for the next year. If Smith & Wesson had not taken such substantial steps to address the flagrant violations of the FCPA, it is likely the financial penalties would have been far more severe and the case could have resulted in criminal prosecution as well, rather than simply being handled administratively.

The lessons to be learned from this case are evident. The remedial acts taken by Smith & Wesson are steps companies should take before there are any violations of the FCPA. At a minimum, a company would ensure that it is not in violation of the internal controls provisions of the FCPA, but it is more important to fulfill the substantive spirit of such controls by creating an atmosphere where corrupt methods of doing business will not be tolerated, which would embolden compliance with the anti-bribery and books and records provisions of the FCPA.

It is imperative that companies ask themselves whether they are FCPA compliant now, before there is a problem. Procopio can help you with that assessment, and help you prepare a compliance program which fits your business practices and needs. Also, if your company finds itself facing a government charge of FCPA violations, we can assist you with your internal investigation and response to the allegations.

Robert G. Marasco utilizes his experience as a former Assistant United States Attorney to effectively and efficiently defend corporate clients and individuals, in all contexts, who are working through complex internal or government investigations, responding to grand jury and administrative subpoenas, or facing criminal prosecution. In the business context, for example, Mr. Marasco assists clients with matters involving the Foreign Corrupt Practices Act (FCPA) and other anti-bribery provisions; fraud allegations; privacy and security breaches; and the defense of professional licenses. He can be reached at 619.906.5732 or robert.marasco@procopio.com.