

Regulatory Hotline

March 09, 2017

SEC'S \$13 MILLION BITE INTO CADBURY

- In early January this year, US-based Mondelez International, Inc. ("**Mondelez**"), the global confectionary giant, settled a five-year old investigation by the U.S. Securities and Exchange Commission ("**SEC**") for alleged bribery, without agreeing with or denying allegations, for \$13 million.
- The investigation was in relation to compliances arising from certain transactions with agents regarding a new manufacturing plant at Baddi, Himachal Pradesh, India by Mondelez India Foods Pvt. Ltd (formerly known as Cadbury India Pvt. Ltd., "**Cadbury India**").
- Although the incident happened before Mondelez had effectively acquired Cadbury India, it co-operated with the SEC and undertook large-scale remedial measures in the process.

In this hotline, we provide the case background, describe the salient features of the SEC order and discuss implications of this case. This case is highly relevant for foreign companies doing business in India, or a company aiming to acquire an Indian company or a foreign company with an Indian subsidiary.

BACKGROUND

In 2005, Cadbury India set up a production plant in Baddi, Himachal Pradesh.ⁱ In 2009, Cadbury India decided to add another floor to the existing plant ("**Unit II**") to increase production capacity.ⁱⁱ

Cadbury India wanted to take advantage of the ten-year excise duty holiday scheme provided by Indian government to new manufacturing plants. To avail this benefit, it needed to have Unit II declared as a new manufacturing plant and to make the new plant operational by March 31, 2010. It retained a third-party agent ("**Agent 1**") in January 2010 to help with required government licensing and approvals for Unit II.ⁱⁱⁱ

In February 2010, US-based Kraft Foods, Inc. acquired UK-based Cadbury Limited ("**Cadbury**"), of which Cadbury India was a wholly-owned subsidiary. About two years after the acquisition, Kraft Foods changed its name to Mondelez International, Inc.

After the acquisition, Mondelez started a company-wide diligence to review and revise Cadbury's policies and practices to meet US and international standards.^{iv} During the internal investigation, it found the discrepancies in its dealings with Agent 1. The investigation found that payments made to Agent 1 could have been passed on to government officials as bribes.^v

The investigation report was supposed to be an internal, confidential document, but a whistleblower provided it to the SEC and the *Wall Street Journal* newspaper.^{vi} The SEC started its own investigation and issued a subpoena to Mondelez. Mondelez cooperated with SEC.

Independent of SEC proceedings, Mondelez had undertaken extensive remedial measures, including termination of Agent 1 in October 2010 and implementation of Mondelez's global compliance program at Cadbury and review of third parties in Cadbury India's business.

In light of the proceedings that had been initiated by SEC, Mondelez Inc. proposed a settlement offer to the SEC, which the SEC accepted, and imposed a civil penalty of US \$13 million on Mondelez.

ORDER

On February 1, 2011, the SEC issued a subpoena to Mondelez regarding its investigation under the FCPA.^{vii} The subpoena requested information regarding Cadbury India's dealings with Indian government officials for obtaining the approval for the new plant.^{viii} Five years later, on February 11, 2016, the SEC issued a "Wells" notice indicating that the SEC staff had determined to file an enforcement action for violations of the Securities Exchange Act, 1934 ("**Exchange Act**")^{ix}. On January 6, 2017, the SEC declared the settlement order with a civil penalty.^x

In the order, the SEC identified two possible violations of the Exchange Act while referring to the possibility of Mondelez violating the Foreign Corrupt Payments Act ("**FCPA**"), which criminalizes acts of bribery indulged in by US companies on foreign soil. The SEC raised the following two issues:

1. Cadbury was in violation of Section 13(b)(2)(A) of the Exchange Act, whereby companies governed by the SEC are required to make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the company; and

Research Papers

Compendium of Research Papers

April 11, 2024

Third-Party Funding for Dispute Resolution in India

April 02, 2024

Opportunities in GIFT City

March 18, 2024

Research Articles

Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

Emerging Legal Issues with use of Generative AI

October 27, 2023

Audio

IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

The Midnight Clause

February 29, 2024

Enforceability of unstamped or inadequately stamped Arbitration Agreements

January 10, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Cyber Incident Response Management

February 28, 2024

Webinar : Navigating Advertising

2. Cadbury was in violation of Section 13(b)(2)(B) of the Exchange Act, whereby companies under the jurisdiction of the SEC are required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:
- transactions are executed in accordance with management's general or specific authorization;
 - transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;
 - access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

On the first issue, the SEC stated that the records that were maintained by Cadbury India did not accurately and fairly reflect the nature of the services rendered by Agent 1. The SEC was of this opinion due to the discovery that the tasks which were ostensibly done by Agent 1 were in reality all carried out by the staff of Cadbury itself, and because the payments that were made to Agent 1 were all withdrawn immediately in cash. These facts coupled with the fact that Cadbury did not implement compliances under FCPA at Cadbury India, led the SEC to conclude that there was a risk that payments could be used towards improper or unauthorized purposes. Therefore, SEC concluded that Cadbury violated Section 13(b)(2)(A) by failing to keep accurate books, records and accounts.

On the second issue, the SEC stated that Cadbury did not effectively monitor the activities of Agent 1, and there was no accountability enforced towards Agent 1. Hence it failed to comply with the standards laid down in Sec. 13(b)(2) (B) of the Exchange Act, as they failed to maintain internal accountability controls.

Pursuant to Section 21C of the Exchange Act, the SEC ordered that Mondelez "cease-and-desist" any activities that have violated, are violating, or will in the future violate the provisions of the Exchange Act and the FCPA. The rationale behind the cease-and-desist order is to prevent violations under the FCPA, and the improper and unauthorized use of funds which as per the SEC amounted to likely violations of FCPA.

ANALYSIS

This order by the SEC highlights the likely censure that US-based companies will face in case of their possible mishandling of their affairs on foreign soil, especially with regards to the maintenance of proper accounts and documents by their subsidiaries.

The SEC investigation highlights the need for companies to follow detailed procedure in vetting their contracts with third party agents. It also puts emphasis on carrying out thorough due diligence in the transactions they undertake.

This type of matters are difficult for the SEC to monitor, but the Mondelez settlement shows the strong intent of the SEC in having effective compliance in matters of third-party agents and transaction-related due diligence. As a matter of caution, companies entering into such dealings must also have ample disclosures regarding the fair and ethical practices that they wish to adhere to, and at a structural level must have anti-corruption programs in place to prevent such eventualities from occurring.

A careful read of the order would also offer an insight into the SEC's approach towards liability of parent companies. The order specifically mentions the efforts taken by Mondelez to ensure compliance with SEC provisions, whereby they ceased any dealings with the agent concerned and also implemented global transparency standards. It is important to highlight such cognizance taken by the SEC in these matters, as it reassures companies of the balanced approach taken by the SEC.

The order specifically comments on the responsibility of Mondelez vis-a-vis Cadbury, since Mondelez acquired Cadbury's stock. It identifies that Mondelez's post acquisition due diligence failed to identify the relationship between Agent 1 and Cadbury. This is also indicative of standards that must be met with by acquiring companies with respect to the due diligence that they must undertake post acquisition.

– Niyati Gandhi, M.S. Ananth & Mihir Parikh

You can direct your queries or comments to the authors

ⁱ "Possible corrupt act by Cadbury in India: Kraft" Rediff.com, March 4, 2011. <http://www.rediff.com/money/report/possible-corrupt-act-by-cadbury-in-india-kraft/20110304.htm>

ⁱⁱ "Cadbury Uses Creative Defense in India Tax Case" by Joe Palazzolo. *The Wall Street Journal*. August 8, 2013. <http://www.wsj.com/articles/SB10001424127887323838204579000840402213258>

ⁱⁱⁱ Securities and Exchange Commission of the USA vs. Cadbury Limited and Mondelez International, Inc. (Release Nos. 34-79753, AAER-3841; File No. 3-17759). January 6, 2017. <https://www.sec.gov/litigation/admin/2017/34-79753.pdf>

^{iv} "Possible corrupt act by Cadbury in India: Kraft" Rediff.com, March 4, 2011. <http://www.rediff.com/money/report/possible-corrupt-act-by-cadbury-in-india-kraft/20110304.htm>

^v "SEC Prepares Civil Charges Against Mondelez in Cadbury Probe" by Joe Palazzolo, Christopher M. Matthews and Aruna Viswanatha. *The Wall Street Journal*, October 13, 2015. <http://www.wsj.com/articles/secpreparescivilchargesagainstmondelezincadburyprobe1444759603>

^{vi} "SEC Prepares Civil Charges Against Mondelez in Cadbury Probe" by Joe Palazzolo, Christopher M. Matthews and Aruna Viswanatha. *The Wall Street Journal*, October 13, 2015. <http://www.wsj.com/articles/secpreparescivilchargesagainstmondelezincadburyprobe1444759603>

^{vii} "Possible corrupt act by Cadbury in India: Kraft" Rediff.com, March 4, 2011. <http://www.rediff.com/money/report/possible-corrupt-act-by-cadbury-in-india-kraft/20110304.htm>

^{viii} "Cadbury Uses Creative Defense in India Tax Case" by Joe Palazzolo. *The Wall Street Journal*. August 8, 2013. <http://www.wsj.com/articles/SB10001424127887323838204579000840402213258>

^{ix} Mondelez International Quarterly Filing (Form 10-Q), Period Ending 09/30/16. Filing Date: October 26, 2016. Note 11. Commitments and Contingencies, p.27. <http://ir.mondelezinternational.com/secfiling.cfm?filingID=1193125-16-747755&CIK=1103982>

^x Securities and Exchange Commission of the USA vs. Cadbury Limited and Mondelez International, Inc. (Release Nos. 34-79753, AAER-3841; File No. 3-17759). January 6, 2017. <https://www.sec.gov/litigation/admin/2017/34-79753.pdf>

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your

Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

