

# 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.<sup>i</sup> In 2009, Cadbury India decided to add another floor to the existing plant ("**Unit II**") to increase production capacity.<sup>ii</sup>

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.<sup>iii</sup>

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.<sup>iv</sup> 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.<sup>v</sup>

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.<sup>vi</sup> 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.<sup>vii</sup> The subpoena requested information regarding Cadbury India's dealings with Indian government officials for obtaining the approval for the new plant.<sup>viii</sup> 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**")<sup>ix</sup>. On January 6, 2017, the SEC declared the settlement order with a civil penalty.<sup>x</sup>

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

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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

<sup>i</sup> "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>

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

<sup>iii</sup> 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>

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<sup>v</sup> "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>

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<sup>ix</sup> 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>

<sup>x</sup> 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>

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