Recent Developments Highlight Value of Robust Compliance Programs in Avoiding Prosecution for Employee Conduct, May Signal US Authorities’ Response to FCPA Reform Pressures

May 24, 2012

Recent weeks have highlighted the value of effective corporate compliance programs in deflecting enforcement activity against companies. At the same time, they have raised new questions about when companies will be held responsible for the actions of their employees, and when such actions will be viewed as “rogue” conduct. Below we contrast the enforcement position in two recent cases: the Morgan Stanley/Garth Peterson matter, involving a corporate declination, and the Noble Corporation/Noble executives matter, including a corporate non-prosecution agreement (NPA).

Morgan Stanley Gets a Pass, Former Managing Director May Get Jail Time

The US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC) announced on April 25, 2012 parallel enforcement actions against Garth Peterson, a former Morgan Stanley Managing Director, who had been in charge of that firm’s real estate investment business in Shanghai, China. The DOJ announced that Peterson had pleaded guilty to one count of conspiracy to circumvent Morgan Stanley’s internal controls, which Morgan Stanley was required to implement under the FCPA. The SEC filed a settled enforcement action alleging Peterson had violated the FCPA’s anti-bribery provisions, circumvented Morgan Stanley’s internal controls in violation of Section 13(b)(5) of the Exchange Act, and aided and abetted violations of the anti-fraud provisions of the Investment Advisors Act of 1940 in connection with the same conduct.

The charging documents allege that Peterson had engaged in a pattern of conduct through which he allowed a prominent local government official from a Shanghai district government-owned and controlled property management and development company (a state-owned enterprise) to personally invest in transactions in which Morgan Stanley was involved, in return for that official’s steering investment opportunities to Morgan Stanley, and providing or securing the necessary Chinese government approvals. In addition to allowing the official to personally invest in Morgan Stanley’s investment transactions, Peterson himself also co-invested in the transactions with the Shanghai-based government official, and a Hong Kong-based Canadian attorney. Both DOJ’s and SEC’s charging documents detail Peterson’s, the official’s, and the Canadian attorney’s significant – and initially successful - efforts to circumvent Morgan Stanley’s internal control mechanisms, which evidently had identified the company’s investment transactions with the Shanghai district government-owned property development company as presenting some risk under the FCPA. They detail how these individuals deliberately misled Morgan Stanley’s internal compliance personnel responsible for conducting due diligence and administering other aspects of Morgan Stanley’s compliance program as it related to its Shanghai-based real estate investment business.

In detailing Peterson’s conduct, the DOJ and SEC settlements contain extensive descriptions of Morgan Stanley’s compliance program, and how it applied to Peterson and the activities that were the subject of the enforcement actions in particular. These settlements represent the first time that either DOJ or SEC has publicly declined to bring enforcement actions against a company on the basis of an oft-suggested “rogue” employee action. They also represent the first time that either agency has specifically and publicly enumerated the FCPA compliance steps that they deemed sufficient to warrant a declination.
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For his part, Peterson agreed with the DOJ to plead guilty to criminal conspiracy to circumvent Morgan Stanley’s internal controls, and agreed to SEC’s filing of a settled enforcement action requiring that he be permanently barred from the US securities industry, pay more than $250,000 in disgorgement, and forfeit his interest in approximately $3.4 million in corruptly-acquired Chinese real estate holdings. He is scheduled for criminal sentencing on July 17, 2012. Morgan Stanley’s declination, on the other hand, allows the Company to retain all of the financial benefits of Peterson’s conduct, which were non-trivial.[1]

Morgan Stanley’s Compliance Program

DOJ and SEC identified the following elements of Morgan Stanley’s compliance program, implicitly suggesting their importance to their decisions not to charge the company in connection with Peterson’ conduct:

- **Policies and procedures:** Morgan Stanley had implemented an (apparently robust) FCPA/anti-corruption compliance policy that prohibited bribery generally, and maintained issue-specific policies and procedures relating to topics such as political contributions, gifts and entertainment, and other areas.

- **Compliance resources:** The agencies cited Morgan Stanley’s extensive compliance infrastructure to implement and administer its policies and procedures, including maintaining over 500 compliance officers worldwide, which included regional and dedicated anti-corruption compliance officers expert in risks prevalent in the company’s various geographic locations. Those compliance personnel were responsible for providing training to company employees, and advising personnel in the field on particular transactions such as the retention of third party agents, due diligence reviews on specific deals, and pre-review of business expenses.

- **Training:** Employees were routinely trained on FCPA/anti-corruption issues in person, electronically and through written materials that were subsequently included in the employees’ personnel files.

- **Ongoing communication efforts:** To reinforce messages delivered in its training sessions, Morgan Stanley issued reminders about compliance with its policies and procedures to Peterson and the rest of its personnel on multiple occasions (including 35 times to Peterson during his tenure with the company), and included reminders about specific local or regional issues, such as the Beijing Olympics in 2008.

- **Transaction-specific controls:** Morgan Stanley conducted extensive due diligence on its new business partners in general, and in particular in connection with the transactions in which Peterson, the Chinese official, and the Hong Kong-based Canadian attorney were involved. Those due diligence efforts included interviewing outside parties including the Canadian attorney (who made false representations to Morgan Stanley), making “pretextual phone calls” to the offices of prospective business partners in order to establish the party’s existence, obtaining written assurances from potential counterparties about legal entities’ existence, and other activities. Morgan Stanley also maintained a strict protocol for approving payments made to business partners, which required financial controllers not otherwise involved in the transactions to approve before a payment was made.
Notwithstanding these and other controls, Peterson managed to channel significant interests in Morgan Stanley’s transactions – and direct cash compensation through distributions from their illicit investments – to the Chinese official, the Canadian attorney, and himself through a series of misrepresentations and corrupt arrangements.

Evolving Compliance Program Standards – Or Just a Particularly Egregious Set of Facts?

The SEC’s and DOJ’s decisions to issue declinations to Morgan Stanley contrast with other recent enforcement decisions where companies as well as their employees were either prosecuted or subjected to some type of sanction for conduct in a foreign operation.

In what has up to now been a highly unusual occurrence, on February 24, 2012 the SEC brought unsettled enforcement actions in the Southern District of Texas against three management-level officials of Noble Corporation -- the former CEO, the former Controller, and the current Nigeria Country Manager -- in connection with their alleged roles in payments made to Nigerian freight forwarders which these individuals allegedly knew would be passed on to Nigerian customs officials. The payments to the Nigerian Customs Service personnel allegedly were made in order to secure temporary importation permits, and extensions to those permits, which were required for Noble’s oil rigs operating in that country.[2]

Noble Corp. had reached settlements with the DOJ and SEC in connection with the same underlying conduct in November 2010, in connection with the so-called Panalpina settlements.[3] Similar to the Peterson/Morgan Stanley case, the criminal information attached by the DOJ to Noble’s NPA alleged circumvention of Noble’s internal control mechanisms: it alleged that Noble had maintained an FCPA compliance program, and that certain Noble employees had circumvented Noble’s Audit Committee’s direction to remediate the temporary importation permit-related problems in Nigeria, by representing that they had done so, to both internal auditors and the Board of Directors itself, when in fact they had not. In contrast to the Peterson/Morgan Stanley resolutions, however, the circumvention of the company’s internal controls – and, indeed, seemingly deliberate misrepresentations to the board of directors by management – did not result in Noble’s receiving a complete declination. However, in contrast to the other voluntary disclosing companies in the Panalpina cases, who received deferred prosecution agreements, Noble received an NPA. In contrast to Morgan Stanley, on the other hand, Noble had to pay criminal penalties and disgorge benefits.[4]

How can these differences be explained? Both companies made voluntary disclosures, both cooperated with the government, both had existing compliance programs, both conducted extensive internal investigations, and both engaged in remediation. In both cases as well, the compliance program seemed to have identified issues with the subject conduct, and in both cases, the conduct at issue involved only a single foreign operation. To our eye, a few factors stand out as potentially influencing the different outcome of the two cases:
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- First, the differential treatment may reflect a judgment by DOJ and SEC as to the extent and effectiveness of the two companies’ FCPA compliance programs. The above recitation makes clear that Morgan Stanley’s program was particularly robust. Noble’s was far from undeveloped[5], and both programs identified issues with the conduct in question, but the elements highlighted in the Peterson case seem designed to underscore just how extensive Morgan Stanley’s efforts were. (They also, incidentally, negate the oft-expressed concern of companies that any improper conduct by an employee will ipso facto demonstrate the ineffectiveness of a company’s program and controls.) It appears, only a fully developed (in terms of elements) and fully implemented (and therefore resourced) program could hope to qualify under the Morgan Stanley standard.

- Second, the element of personal benefit derived by Peterson from his conduct is likely significant. No such benefits are alleged in the Noble Corp. executives’ case. Such benefits call into question whether Peterson was really acting for the benefit of his employer, a key requirement for corporate vicarious liability. Moreover, it seems clear that the government believes Morgan Stanley was ultimately duped by its employee and entered into transactions in good faith, without knowledge of the personal benefits being derived, despite their controls.

- Third, the level of personnel involved may be significant. While Peterson was a relatively senior Morgan Stanley executive in China, he did not occupy a senior management or gatekeeper position, as did Mark Jackson, Noble Corp.’s former CEO, or Thomas O’Rourke, the former Corporate Controller, two of the three executives currently subject to SEC’s unsettled enforcement action.

- The final possibility is that the declination was motivated by the enforcement agencies’ desire to respond to entreaties from companies and business groups to demonstrate the value of compliance efforts. The Peterson case comes as the DOJ and SEC are drafting long-awaited public guidance on the statute,[6] in the wake of concerns that the implementing regulations for the Dodd-Frank whistleblower provisions gave short shift to corporate compliance efforts.[7] Whether ultimately the Peterson/Morgan Stanley resolution will be looked back on as part of a larger effort by the agencies to demonstrate they have credited companies for their compliance efforts – even when they benefit (albeit unknowingly at the time) from a “rogue employee’s” conduct – remains to be seen. The case and the questions it raises in relation to other recent enforcement actions reinforce the importance of the Guidelines’ addressing this critical issue.

We will continue to keep you apprised of developments related to FCPA and anti-corruption law enforcement. If you have any questions or would like further information, please feel free to contact Lucinda Low at 202.429.8051, Owen Bonheimer at 202.429.6266, or Tom Best at 202.429.8079.

[1] The criminal information filed by the DOJ indicates that the Chinese official steered one transaction in particular (“Project Cavity”) to Morgan Stanley in 2004, in which the official, Peterson, and the Canadian attorney subsequently invested in 2006. See DOJ Information, at paras. 30-33. The SEC complaint alleges that Peterson, the Chinese official, and the Canadian attorney purchased 12% of the Project Cavity real estate for $3 million in 2006, at Morgan Stanley’s 2004 basis, and that this interest was approximately $6 million “in the money” due to the appreciating price of real property in Shanghai. See SEC Complaint, at paras. 14-16. As a result, Morgan Stanley’s interest in Project Cavity, apparently procured through Peterson’s corrupt dealings, could have been worth as much as $75 million, and could have appreciated over 300% between mid-2004 and mid-2006.
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[3] See our International Law Advisory of November 29, 2010. It seems likely that Noble’s compliance program investments, including internal auditing efforts, contributed to that more favorable treatment.

[4] Pursuant to its NPA, Noble Corp. paid $2.59 million in criminal penalties to the DOJ, and had to agree to certain cooperation and other conditions. Noble Corp. also agreed to a settled enforcement action with the SEC, which resulted in its payment of $4.3 million in disgorgement and $1.3 million in prejudgment interest to that agency.

[5] The Noble NPA is not as detailed as the Peterson documents regarding the company’s compliance efforts, but it does mention internal auditing activities, including an audit that initially identified the temporary importation permit-related issue in Nigeria in 2004, management’s decisions to remediate the problematic practices, the Audit Committee’s selection of a senior executive as responsible for that remediation, and the Audit Committee’s subsequent follow-up on the issue. The NPA also notes the existence of Noble’s FCPA compliance manual, which included a section addressing “facilitating” payments, specific approval procedures for making such payments, and training efforts provided to employees, including senior management.


Introduction

The Foreign Corrupt Practices Act (FCPA) continued to be a hotbed of activity in 2011. Although aggregate fines fell precipitously between 2010 ($1.8 billion) and 2011 ($508.6 million), that decline was more a reflection of the anomalies of 2010 than of 2011. 2011 saw significant enforcement activity against both corporations and individuals, as well as the development of substantive legal issues that will likely have lasting effects on FCPA law and practice.¹

Enforcement agencies continued the trend of targeting individuals in 2011. While 16 companies were targeted in 2011, 19 different individuals were the targets of new FCPA enforcement actions.

Judicial decisions—either interlocutory rulings or trial results—were the “wild card” of 2011. Several cases featured challenges to the definition of “foreign official,” specifically whether the FCPA’s scope encompasses officers and employees of state-owned enterprises (SOEs). While the decisions, which are described in detail below, did not per se exclude SOEs from the definition of “foreign official,” they did indicate that an officer or employee of an SOE should not automatically be defined as a “foreign official” without further analysis.

Finally, the most notable FCPA issue of 2011 was the government’s difficulty obtaining (or in the case of Lindsey Manufacturing, preserving) FCPA convictions. The government went to trial three times in FCPA related cases in 2011—two trials in the Shot Show cases as well as in Lindsey Manufacturing—without being able to secure a conviction. Additionally, in early 2012, the government was unsuccessful in its trial of the O’Shea case. However, the government was able to secure one conviction in 2011 in the Haiti Teleco case.

Along with heightened World Bank enforcement, 2011 also saw the entry into force of several new legislative initiatives, including the Dodd-Frank Whistleblower Regulations, the UK Bribery Act and significant amendments to China’s PRC Criminal Code. How these additions will affect anti-corruption enforcement is a question that remains to be answered.

If you have any questions or for further information, please feel free to contact Lucinda Low at 202.429.8051.

¹ The Appendix to this Year in Review contains a summary of the 2011 corporate cases by legal element.
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I. Summary Statistics

In 2011, there were a total of 49 enforcement actions brought against companies and individuals: 24 were brought by the Department of Justice (DOJ) and 25 by the Securities and Exchange Commission (SEC). While the total number of enforcement actions was down from 2010, this is likely due to the government’s concentration on the 2011 FCPA trials (described in further detail below).

Through 24 enforcement actions, a total of 16 companies faced new charges from the DOJ, SEC, or both. Additionally, there were 25 separate FCPA enforcement actions against 19 individuals.
In total, 15 companies paid a sum of $508.6 million in penalties, disgorgement and prejudgment interest, significantly less than in 2010 and the least since 2007. However, this should not be seen as a sign of the government’s deemphasizing FCPA enforcement. Indeed, this is a likely result of resources being diverted from corporate settlements to trial preparation and execution, and the fact that 2010 saw a culmination of a number of cases with large penalties (for example, Alcatel-Lucent, BAE Systems, Panalpina World Transport, Shell Nigeria Exploration and Production Company, ABB Ltd., Snamprogetti Netherlands B.V., Innospec, and Daimler A.G.) that had been going on for several years.
The highest DOJ FCPA fine in 2011 was $218 million against JGC Corporation, the last remaining consortium member in the Bonny Island case. The lowest DOJ fine was $1.2 million against Converse Technology Inc. The highest SEC penalty (inclusive of disgorgement, prejudgment interest and penalty) was $48.6 million against Johnson & Johnson, with the lowest being $300,000 against Ball Corporation. The total mean DOJ and SEC penalties were $36.1 million and $11.36 million respectively.
In 2011, alleged FCPA violations occurred in 15 countries, and in all regions of the world. While Africa was previously a hotbed of FCPA violations, 2011 saw only one enforcement action related to conduct in Africa (Nigeria). Conduct in Asia, and specifically China, resulted in more enforcement actions than any other region (or country). The increased number of enforcement actions emanating from conduct in the Americas is also noteworthy.

II. Important Judicial Decisions in 2011 – the SOE Challenges

Among the more significant FCPA developments in 2011 were judicial rulings addressing the definition of government “instrumentality,” a term undefined in the FCPA. Because the FCPA prohibits payments to “foreign officials,” defined to include employees of government instrumentalities as well as agencies and departments, and because the DOJ and SEC have frequently brought enforcement actions based on payments to employees of SOEs on the ground that they are employed by instrumentalities, the construction of this term has critical implications for the FCPA’s reach. The DOJ and SEC have long asserted that SOE employees qualify as “foreign officials” to whom improper payments are prohibited. Corporate and individual defendants have rarely challenged this assertion, and even when they have, courts have tended to summarily dismiss their efforts.2

In the Control Components Inc. and Lindsey Manufacturing cases this year, however, the court issued substantive rulings on the meaning of this term. In doing so, the courts made a rare and important contribution to the sparse case law interpreting the FCPA. As also discussed in our previous advisory, each judge’s decision found that the determination required a fact-specific inquiry, with each court developing slightly different multi-factor tests to guide its analysis.

In U.S. v. Noriega (the “Lindsey Manufacturing” case), the court rejected the defendant’s arguments that Mexico’s Comision Federal de Electricidad (CFE) was not an instrumentality under the Act. The defendant contended that the plain meaning of “instrumentality” does not encompass SOEs, that the legislative history supported this finding, and that the term itself was so ambiguous as to qualify for application of the rule of lenity and the void-for-vagueness doctrine. The court, however, denied a categorical approach, instead offering an illustrative set of non-exclusive characteristics relevant to determining whether a particular entity was a “government instrumentality” under the FCPA. These included whether:

- The entity provides services to citizens of the jurisdiction
- Key officers and directors are, or are appointed by, government officials

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• The entity is substantially financed through government taxes, royalties, fees, appropriations or other such revenues

• The entity is vested with controlling authority to discharge its functions

• The entity is perceived and acknowledged to perform governmental or official functions

Applying this test to the CFE, the court observed that the CFE was owned by Mexico’s government, that it supplied electricity to the entire country outside the capital, that government officials comprised its governing board, that Mexican law defined it as a “public entity,” that it defined itself as a governmental “agency,” and that Mexico’s Constitution provided that the supply of electricity is an exclusively governmental function. On these facts, the court concluded that CFE was indeed a government instrumentality. Lindsey Manufacturing was convicted on all counts on May 10, 2011, the first post-trial conviction of a corporate defendant in the FCPA’s history (although the conviction was later dismissed on grounds of prosecutorial misconduct).

The defendant in U.S. v. O’Shea also moved to dismiss charges using arguments similar to those in Lindsey Manufacturing, as O’Shea was also accused of bribing the CFE. O’Shea asserted that ownership was insufficient to show that an entity is an instrumentality, arguing that there must also be governmental purpose or function for an entity. The court did not rule on defendant’s motion or let the question reach a jury, however, as the judge dismissed all FCPA charges following the presentation of the government’s case.

Considering the same issue, the court in United States v. Carson et al. (the Control Components or CCI case), developed its own non-exclusive, fact-specific test for determining whether an entity is a government instrumentality. It held that among the factors to be considered are:

• The purpose of the entity’s activities

• The foreign country’s level of control over the entity

• The entity’s rights and obligations under the foreign state’s law, including the degree to which the entity enjoys exclusive or controlling authority to exercise its functions

• The circumstances of the entity’s creation

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- The foreign state’s degree of ownership, including the extent of financial support (e.g., loans, tax treatment, subsidies) provided by the state
- The foreign state’s own characterization of the entity and employees\(^5\)

Although the *CCI* and *Lindsey* rulings found that the SOEs at issue were indeed instrumentalities of a foreign government and that their employees were thus foreign officials, the fact-specific approach adopted by the courts may present opportunities for defendants to challenge DOJ and SEC claims of prohibited payments. While the facts in *Lindsey Manufacturing* presented a fairly straightforward finding, it is not clear that the types of SOEs in *CCI* fit as cleanly into the courts’ tests.

Given the diverse range of government participation in commercial enterprises, other types of cases may prove even more difficult to ascertain if an SOE qualifies as a government instrumentality. How, for instance, will a government’s minority interest in a joint venture be treated if the government maintains a substantial degree of control? Or a publicly traded company in which the government owns a controlling share? Or a subsidiary of an SOE engaged in commercial activities with a separate governance structure? Given the array of possible permutations, there may be room for defendants in a particular case to mount convincing arguments that they did not make improper payments to “foreign officials” as employees of government instrumentalities.

The adoption of a multi-factor test also raises questions regarding the types of evidence used to prove whether an entity is indeed a government instrumentality. In the *Lindsey* case, for example, the court did not allow the government to submit an affidavit from a US State Department official concluding that the CFE was a government instrumentality. The judge in the *O'Shea* case, however, ruled the affidavit admissible. In the *Haiti Teleco* case, defendants submitted a declaration from a former Haitian official stating that Haiti Teleco was not in fact a state enterprise.\(^6\) The government responded by submitting its own declaration from the same individual backing away from the conclusion, and disavowing any intent that it be used to support defendants’ arguments that Haiti Teleco was not part of Haiti’s public administration.

How courts will apply the definition of government “instrumentality” in the future and the types of evidence used to support arguments either way remains to be seen. What is clear, however, is that the *Lindsey* and *CCI* rulings have opened a new front on the scope of this critical element of the FCPA. Of course, for companies subject to the UK Bribery Act and other transnational bribery statutes that apply equally to private and public sector actors, this is but a tempest in a teapot. Moreover, the tests articulated by the *Lindsey* and *CCI* courts are hardly practical for day-to-day compliance assessments, given the detailed legal and factual research

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\(^5\) Order Denying Motion to Dismiss, *U.S. v. Carson et al.*, No. 09-77. Trial in the case is scheduled for June 2012.

they require. Accordingly, many companies will likely contrive to use conservative, bright-line
tests instead of staking their freedom from prosecution on two lower court decisions.

III. Challenge of Obtaining FCPA Convictions in 2011

The government faced major setbacks in its pursuit of FCPA convictions in 2011. The first two SHOT Show Trials resulted in a mistrial and the dismissal of conspiracy counts, respectively (as this Report was being finalized, the DOJ announced it would not pursue the remaining cases); in Lindsey Manufacturing, although the government initially won a conviction, the conviction was thrown out due to prosecutorial misconduct; and in O’Shea, the defendants recently won a directed verdict on the substantive FCPA counts. However, not all outcomes were unfavorable to the government, as it did secure a conviction in the Haiti Teleco case.7

A. SHOT Show Trials

In early 2010, the DOJ announced the arrest and indictment of 22 executives and employees of police and military product supply companies for conspiring to bribe foreign officials to obtain or retain business. The indictments represent the largest FCPA investigation and prosecution to date. Twenty-one defendants were arrested in Las Vegas while attending the SHOT Show, an annual firearms exhibition.

According to the indictments, the defendants agreed to sell undercover law enforcement agents military and police equipment to the Gabon Ministry of Defense and to pay the Ministry a 20 percent sales commission with half of the commission paid directly to the minister. The defendants also allegedly agreed to produce two price quotations for the contracts, one reflecting the true cost of the sale and one reflecting an inflated cost containing the 20 percent commission. The defendants were charged in a 44-count superseding indictment with conspiracy to violate the FCPA, violating the FCPA, conspiracy to commit money laundering, and aiding and abetting.

Due to the large number of defendants, US District Judge Richard Leon split the defendants into four groups for trial. The first trial began on May 16, 2011. However, on July 7, 2011, after the jury had deliberated for five days without reaching a verdict, the judge declared a mistrial.

On September 28, 2011, the trial for the second group of defendants commenced. However, after a twelve-week trial, Judge Leon dismissed the conspiracy counts against the defendants due to lack of evidence presented by the prosecution.

On February 21, 2012, the DOJ filed a motion to dismiss the indictments against all remaining defendants. While this was not surprising given the government’s inability to secure a conviction in the first two trials, the outcome is a significant setback for the government, which expended significant resources and zeal to both investigate and prosecute these cases.

7 The result of the Haiti Teleco trial is described more fully in section VI, below.
B. **Lindsey Manufacturing**

In December 2009, the DOJ filed a complaint in the US District Court for the Central District of California against Enrique Aguilar Noriega (“Aguilar”), a Mexican agent for Lindsey Manufacturing Co., a California-based company that makes and sells emergency restoration systems and other equipment for electric utility companies. The DOJ alleged that Aguilar had won sales contracts for Lindsey Manufacturing with the CFE, a Mexican state-owned electric utility, by forwarding to CFE personnel a portion of his own 30% sales commission. The DOJ subsequently indicted Lindsey Manufacturing and two of its senior officers, President Keith Lindsey and Vice-President and CFO Steve Lee, on counts of conspiracy to violate the FCPA, conspiracy to commit money laundering, money laundering and aiding and abetting.

Lindsey gained notoriety as the first corporate defendant to litigate an FCPA charge in more than 25 years. The jury returned guilty verdicts on May 11, 2011 against all defendants, despite having heard no evidence of any direct involvement in, or knowledge of the bribes by the Lindsey defendants. Sentencing was to be set for September 2011. In the interim, the defendants filed a motion to dismiss the verdict on grounds of prosecutorial misconduct. They alleged that the prosecutors failed to timely turn over exculpatory evidence and concealed inconsistencies in the evidence presented by key witnesses. After hearings on the motion Judge Howard Matz vacated the guilty verdicts and dismissed the indictments against the Lindsey defendants on December 1, 2011. Despite this outcome, the judge’s interim order on the scope of the “foreign official” and “government instrumentalities” elements of the statute as applies to state-owned enterprises stands.

The government has appealed the dismissal to the US Court of Appeals Ninth Circuit. It seems likely that the defendants will cross appeal the District Court’s SOE ruling, which will allow the Ninth Circuit to become the first appellate court, but unlikely the last, to weigh on this element.

C. **O’Shea (2012)**

The general manager of Sugar Land, John Joseph O’Shea, was accused of paying kickbacks to CFE officials, the same agency at issue in Lindsey, in exchange for contracts with ABB. Mr. O’Shea was indicted in November 2009 on one count of conspiring to violate the FCPA, twelve counts of violating the FCPA, four counts of money laundering and one count of creating a false document to obstruct the Government's investigation. Specifically, the indictment alleged that Mr. O’Shea, while serving as the general manager for Sugar Land, the Texas business unit of ABB, Inc., a US subsidiary of Swiss corporation ABB, Ltd., arranged and authorized payments through a Mexican sales agent, Esimex, to multiple officials at CFE in exchange for contracts to provide products and services to CFE.8

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8 In September 2010, ABB settled criminal and civil FCPA charges with the DOJ and SEC for a combined $58.3 million.

In a directed verdict, US District Judge Lynn Hughes dismissed the twelve charges directly alleging FCPA violations, ruling the government’s case lacked foundation, lacked specific evidence, and failed to prove the charges. The court found the records that the government’s star witness, Fernando Basurto Jr., whose company O’Shea was accused of using to funnel money to the CFE, had shared with the government were “modest in their extent and inconclusive in their reach.” The judge also ruled that the government couldn’t tie O’Shea to the alleged bribery and cover up.

In early February, the government moved to dismiss the remaining charges against O’Shea, ending the criminal case against him.

IV. Sentences for FCPA Related Conduct in 2011

Difficulty obtaining FCPA convictions aside, the government in 2011 secured significant sentences for five individual defendants in relation to FCPA conduct. Joel Esquenazi, Antonio Perez, and Carlos Rodriguez were sentenced for their involvement in the Haiti Teleco case. Joel Esquenazi received a fifteen-year sentence in October 2011, the longest FCPA-related sentence in the statute’s history. In the same case, Carlos Rodriguez received a seven-year sentence, and Antonio Perez received a two-year sentence. Other cases followed this trend later in the year, including Jorge Granados of Latinode, who was sentenced to 46 months, and Innospec’s Ousama Naaman, who was sentenced to 30 months.

1. Haiti Teleco

On January 21, 2011, Antonio Perez, who pled guilty to one count of conspiring to bribe officials at Telecommunications D’Haiti, was sentenced to two years in prison and ordered to forfeit $36,375. Joel Esquenazi and Carlos Rodriguez were convicted of one count each of conspiracy to violate the FCPA and wire fraud, seven counts of FCPA violations, one count of money laundering conspiracy, and twelve counts of money laundering on August 5, 2011. In addition to their prison sentences, Esquenazi and Rodriguez were ordered to jointly and severally pay restitution of $2.2 million.

Esquenazi and Rodriguez were executives of Miami-based Terra Telecommunications Corp., which executed a series of contracts with Telecommunications D’Haiti (Haiti Teleco), a Haitian state-owned Company. Esquenazi, former president of Terra Telecommunications Corp., and Rodriguez, former executive vice-president, allegedly authorized approximately $814,000 in corrupt payments from 2001 through 2005 to executives of Haiti Teleco in order to obtain various business advantages including: preferred telecommunication rates; a reduced number of minutes for which payment was owed; and credits toward sums owed. Esquenazi and Rodriguez paid executives of Haiti Teleco through shell companies for fictional “consulting services,” and caused the Company to falsely record these payments as “commissions” or

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“consulting fees” in the Company’s books and records. Perez, the controller of the telecommunications company, admitted to conspiring with the former director of international relations for Haiti Teleco to pay bribes of $674,193 to the Haitian officials while he worked at the company from March 1998 to January 2002.

2. LatiNode

Jorge Granados pled guilty in 2010 to authorizing bribes to officials of Honduras’s state-owned telecommunications company, Empresa Hondureña de Telecomunicaciones (Hondutel). After a federal grand jury returned a 19-count indictment, which included charges for conspiracy, money laundering, and numerous violations of the FCPA, Granados was sentenced to 46 months in prison and two years of supervised release. Two years prior to Granados’s sentencing, in 2009, LatiNode pled guilty to a criminal information with one count of violating the FCPA, and agreed to pay a $2 million fine. LatiNode’s parent, eLandia International Inc., discovered the illicit payments when it acquired LatiNode and self-disclosed the payments to the Department of Justice.

From 1999 to 2007, Granados was the CEO and chairman of the board of LatiNode, a Florida corporation that provided international telecommunications services using voice over internet protocol technology. In 2005, LatiNode won an exclusive “interconnection agreement” with Hondutel, which permitted LatiNode to use Hondutel’s telecommunication lines to provide long distance service between the United States and Honduras. Granados, along with several other LatiNode executives, agreed to pay over $500,000 in bribes to a general manager at Hondutel, a senior attorney, and a Honduran government minister who served on Hondutel’s board in order to maintain the interconnection agreement and to receive reduced rates and other economic benefits.

3. Innospec

Ousama Naaman was sentenced to 30 months in prison and fined $250,000 on December 22, 2011 after he pled guilty to a two-count indictment in June 2011, charging him with one count of conspiracy to violate the anti-bribery provisions of the FCPA, commit wire fraud, and falsify books and records of a US issuer; and one count of violating the anti-bribery provisions of the FCPA. Naaman, a dual citizen of Canada and Lebanon, was indicted in 2008 and extradited to the United States from Frankfurt, Germany, where he was arrested in 2009.

Naaman acted as an agent of US-based Innospec Inc. in Iraq, where he promised or paid kickbacks of over $8.5 million to Iraqi government officials in exchange for contracts with the

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14 In March of 2010, Innospec reached a $40 million global settlement on more than a dozen criminal charges in the US and UK, including FCPA and U.N. oil for food program offenses, and violations of the US embargo against Cuba.
Ministry of Oil to purchase a fuel additive from Innospec. Naaman negotiated seven agreements under the United Nations Oil-for-Food Program under which he routed over $5 million to Iraqi government officials. He also paid Iraqi government officials in the Trade Bank of Iraq in exchange for a favorable exchange rate on letters or credit, and created false invoices for the reimbursement of the illicit payments. As an agent for Innospec, Naaman also arranged or paid approximately $91,000 in travel, gifts, and entertainment expenses for Iraqi senior officials.

In arguing for a lesser sentence than the seven and a half years the government requested, Naaman pointed out that the United Kingdom has a more lenient sentencing regime and, because he is the only individual facing charges in the United States, this will likely result in a significant sentencing disparity. He also argued that he should be given credit for time served, pointing out that he spent nearly a year in prison in Germany while awaiting extradition and another seven months under strict conditions of release in the United States.

Although both Granados and Naaman will serve time in prison, their ultimate sentences are both significantly less than the maximum penalties that could have been imposed for the charges brought against them. Granados faced up to five years in prison on the conspiracy and FCPA counts, and up to 20 years on the money-laundering charges. Naaman faced a maximum sentence of fourteen years, with the government arguing for a seven and a half year sentence.

V. 2011 Settlements – The Non-Litigated Cases

In 2011, as in prior years, the majority of FCPA cases were settled rather than litigated. The 2011 DOJ settlements involved pleas, deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs). The SEC, in contrast, used its traditional tools of consent decrees and injunctions, resorting only once, in the Tenaris case (see our previous advisory at http://www.steptoe.com/newsletters-206.html), to a DPA. Below we address a number of the settlements by issue area. The issues are:

- Prosecutions for payments to SOE officials
- The element of obtaining or retaining business
- Enforcement cases involving travel and entertainment
- Prosecutions for violation of the accounting provisions
- Prosecutions in the M&A area

These cases indicate that even as the courts are litigating the reach of the statute, the DOJ and SEC continue to take aggressive positions regarding the statute’s reach, particularly on the issue of SOEs.

A. Prosecutions for Payments to SOE Officials

As described above, many defendants are challenging the scope of “foreign official” as defined under the FCPA, and particularly whether it should encompass employees of SOEs. The cases below highlight settlements in which the alleged violation included employees of SOEs.
1. **Bridgestone**

In September 2011, Bridgestone Corporation, the world’s largest manufacturer of tires and rubber products, agreed to a settlement regarding allegations that it had rigged bids and made corrupt payments to foreign government officials in Latin America in exchange for millions of dollars of sales in marine hose and other industrial products. Specifically, the company allegedly paid local sales agents commissions that included corrupt payments and coordinated the sales of these commissions through its US offices. The company then took steps to conceal the payments by relying primarily on verbal communications to avoid a written record and, in some instances, writing “Read and Destroy” on documents related to the corrupt payments.

In providing corrupt payments in exchange for industrial sales, Bridgestone developed relationships with employees of various SOEs, including PEMEX in Mexico, and focused its negotiations on these employees in order to secure business for Bridgestone. In bringing allegations against Bridgestone, the DOJ noted that it considered employees of SOEs to constitute “foreign officials” under the FCPA.

In settlement, Bridgestone agreed with the DOJ to plead guilty and to pay a $28 million criminal fine for its role. In reaching this agreement, the DOJ acknowledged Bridgestone’s cooperation with the investigation and its efforts to conduct an internal investigation, as well as remedial steps that Bridgestone took, including restructuring relevant parts of its business and terminating many of the third-party agents involved in the corrupt payments.

2. **Comverse**

In April 2011, Comverse Technology, Inc., a New York-based software provider, agreed to settle both criminal and civil allegations that it had violated the FCPA’s accounting provisions. It was alleged that Comverse, through its Israeli subsidiary, Comverse Limited, transferred almost $536,000 to individuals at Hellenic Telecommunications Organization S.A. (OTE) of Greece, a partially state owned enterprise, in order to obtain business. A shell company was incorporated in Cyprus in order to funnel the improper payments and allow Comverse Limited to represent the payments as legitimate agency fees on its books and records.

Although Comverse voluntarily disclosed the payments upon discovery and fully cooperated with the DOJ in its investigation, the SEC alleged that Comverse did not provide anti-corruption training to its employees or maintain adequate controls over payments to agents. The DOJ agreed to a NPA with a $1.2 million penalty, while the SEC required that Comverse consent to an entry of judgment and pay more than $1.6 million in disgorgement and prejudgment interest.

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16 *U.S. v. Comverse Technology, Inc.* (non-prosecution agreement (Apr. 2011)).
3. Maxwell

In January 2011, Maxwell Technologies, Inc. settled criminal and civil FCPA charges with the DOJ and SEC for payments made to a Chinese state-owned electric utility infrastructure manufacturer.\textsuperscript{17} From 2002 through 2009, Maxwell’s wholly-owned subsidiary paid more than $2.5 million dollars in kickbacks to officials in order to secure contracts worth more than $15.4 million. These payments were first detected within the company in 2002 by a Maxwell employee in Europe, and were reported to US headquarters and the former CEO. However, the former CEO failed to act, and the kickbacks continued until 2009 when the new CEO learned of the payments and began an internal investigation, which led to a voluntary disclosure. Maxwell’s alleged violations involved prolonged interactions with a Chinese state-owned entity to which Maxwell’s subsidiary sold high-voltage capacitors at inflated prices, and then transferred them to the SOE employees. Because of their role as alleged “instrumentalities” of the government, the DOJ and SEC considered the employees of the SOE to be foreign officials.

The SEC asserted that Maxwell had failed to maintain adequate controls over payments, had performed inadequate due diligence and did not provide anti-corruption training to its employees, all of which contributed to the prolonged failure to remedy the illegal payments. Maxwell agreed, in a settlement, to disgorge over $6 million including prejudgment interest to the SEC. Maxwell also agreed to a DPA, under which it paid the DOJ $8 million.

4. Watts Water

In October 2011, the SEC issued a cease-and-desist order for alleged FCPA violations by Watts Water Technologies, Inc. and its wholly-owned subsidiary, Watts Valve Changsha Co. Ltd. (CWV), which produces and supplies large valves for Chinese infrastructure projects.\textsuperscript{18} The SEC alleged that employees of CWV made improper payments to employees of various design institutes in order to influence the recommendation of CWV’s products and the creation of design specifications that favored CWV products. The payments allegedly generated profits for Watts of more than $2.7 million, and were disguised as sales commissions within the company’s books and records. The SEC asserted that the design institutes constituted SOEs. Watts agreed to pay $3.77 million in disgorgement, pre-judgment interest and civil penalties.

B. The Element of Obtaining or Retaining Business

The FCPA prohibits payments to any foreign official made to assist an entity in “obtaining, retaining or directing business to any person.” In recent years, following the landmark decision in the Kay case, this so-called “business purpose” test has been interpreted broadly to include almost any bribe that can be shown to improve a company’s profitability. Cases brought in 2011 continue that trend by finding that bribes intended to obtain a customs or

\textsuperscript{17} \textit{U.S. v. Maxwell Technologies, Inc.}, No. 3:11-00329 (S.D. Cal. 2011).

regulatory benefit or to sabotage a competitor were made for the purpose of “obtaining or retaining business.”

1. **Ball Corporation**

   In March, 2011, the SEC claimed that Ball Corporation (Ball), a manufacturer of packaging for household products, discovered that its Argentine subsidiary, Formamental S.A., had paid bribes to government officials prior to its acquisition by Ball. The SEC alleged that Ball failed to implement internal controls to prevent further improper payments and charged Ball with failing to keep accurate books and records.

   The bribes were allegedly paid by Formamental to induce state customs officials to circumvent Argentine laws prohibiting the importation of used equipment and parts. Formamental also sought approval from the government of Argentina to obtain an export duty waiver for copper scrap. The SEC cease-and-desist letter indicated that these efforts were “unsuccessful.” Although the President of Formamental allegedly authorized the bribes believing that the payments were requested by a customs official and would result in a copper scrap duty waiver, no copper scrap export shipments were made as a result of the payment.

   Despite the fact that the bribes did not accomplish their purpose of obtaining an export duty waiver, the SEC still asserted that the payments were improper under the FCPA, indicating that an unsuccessful payment may still be the basis of a business advantage nexus. Ball settled the SEC charges by agreeing to a cease-and-desist order and paying a $300,000 penalty.

2. **Magyar Telekom**

   In December 2011, the DOJ and SEC settled a significant FCPA enforcement action with Magyar Telekom (Magyar), a Hungarian telecommunications company, as well as its majority owner Deutsche Telekom AG of Germany. The alleged actions took place in Macedonia, where Magyar operated through subsidiaries. In 2005, the Macedonian government began liberalization of the Macedonian telecommunications field. In response, Magyar vigorously lobbied the Macedonian government and its officials to prevent implementation of these changes. As part of that lobbying effort, the company entered into a secret agreement where Macedonian government officials would delay certain regulatory actions in exchange for payment. Magyar executives engaged in sham contracts with consultants and third parties where payments of up to $6 million were made with knowledge that there was a high probability that these payments would be passed on to government officials. Magyar’s subsidiary improperly recorded the contracts in their books and records. Additionally, the DOJ alleged that Magyar made improper payments while acquiring a state-owned telecommunications company in Montenegro and utilized four falsified contracts in an effort to hide the payments.

   The DOJ and SEC alleged that the payments were made under the guise of “consulting” and “marketing” contracts that did not have any legitimate business purpose, and further, that

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19 DOJ Digest Nos. D-104, B-126.
Magyar’s actions aimed at delaying regulatory action constituted “obtaining or retaining” business under the FCPA. Magyar and Deutsche Telekom AG agreed to pay a pay a $63.9 million criminal penalty for its actions and $31.2 million in disgorgement and pre-judgment interest to the SEC.

3. **Tyson Foods**

On February 10, 2011, the DOJ entered into a settlement with Tyson Foods Inc. (Tyson) relating to allegations that Tyson’s Mexican subsidiary, Tyson de Mexico, conspired to violate and did violate the FCPA by paying close to $100,000 to Mexican veterinarians whose certifications were required to export chicken products. The DOJ asserted that the veterinarians were “foreign officials” because they conducted the controls and issued the certifications as salaried employees of an inspection program operated by the Mexican Ministry of Agriculture. In line with arguments in other cases, the DOJ alleged that that Tyson’s payments to veterinarians were made for the purpose of “obtaining or retaining business,” tying the payments to profits of $880,000 from export sales. Tyson de Mexico allegedly concealed the improper payments through fraudulent salaries to the veterinarians’ wives. Further, a senior executive at Tyson approved payments using false invoices submitted by the veterinarians.

Tyson Foods disclosed this conduct to the DOJ, and entered into a deferred prosecution agreement that required Tyson pay a $4 million criminal penalty. Tyson also entered into a related settlement with the SEC, which alleged that as a result of these payments and the scheme used to hide them, Tyson violated the books and records and internal controls provisions of the FCPA. Tyson consented to the entry of a final judgment ordering disgorgement plus prejudgment interest of more than $1.2 million.

C. **Enforcement Cases Involving Travel and Entertainment**

In 2011, the US authorities charged several corporations with improper travel and entertainment-related expenses, continuing a trend of focusing on such activity reflected in a number of cases in previous years. While in some cases travel and entertainment expenses were only part of the charged conduct, in at least one case such expenses were at the center of the case. The improper expenses were primarily authorized by subsidiaries of US companies and were subject to enforcement primarily by the SEC. These cases highlight the importance of maintaining internal control systems that ensure that travel and entertainment expenses are appropriate.

1. **Aon**

In December, 2011, the DOJ and the SEC announced criminal and civil FCPA settlements with Aon Corp., a corporation that provides risk management services, insurance and reinsurance brokerage.

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21 U.S. v. Aon Corp. (non-prosecution agreement (Dec. 2011)).
subsidiaries made improper payments to secure contracts in Bangladesh, Costa Rica, Egypt, Indonesia, Myanmar, the United Arab Emirates, and Vietnam. The improper payments included training, travel, and entertainment expenses provided to employees of government-owned clients and third parties, including payments to INS officials for non-training activity, including travel with spouses to overseas tourist destinations and also included trips to the United States for a delegation of officials from the Egyptian Armament Authority and the Egyptian Procurement Office. The SEC alleged that these delegation trips included a disproportionate amount of leisure activities and lasted longer than their business component would justify.

The Aon charges represent the DOJ’s and SEC’s heightened scrutiny of the length and activities paid for by corporations for government officials, and represent an interest in ensuring that inappropriate travel and entertainment is not masked by legitimate activities. Aon entered into a non-prosecution agreement with the DOJ which requires that it pay a fine of $1.76 million. Aon also reached a settlement with the SEC, and Aon Ltd had previously settled with the UK Serious Fraud Office for £5.25 million.

2. Diageo

In July 2011, UK-based liquor retailer Diageo PLC consented to an SEC cease-and-desist order finding that Diageo, through subsidiaries in India, Thailand, and South Korea, made improper payments to government officials to obtain sales and tax benefits in amounts adding up to $2.7 million over six years. In India, these payments included direct payments to Indian government officials with responsibility for sales at government liquor stores (another example of SOEs) and responsibility for approving liquor labels. In Thailand, they included payments to a government official for the purpose of securing his lobbying efforts. And in South Korea, it included cash, travel and entertainment expenditures provided to South Korean customs officials in order to obtain favorable tax treatment.

Diageo’s Korean subsidiary (DK) paid for travel expenses of customs officials and other officials to Scotland, purportedly to inspect Diageo’s scotch production facilities. During the course of this trip, DK employees took the South Korean officials on a purely recreational side trip to Prague and Budapest. Additionally, DK employees routinely made hundreds of small holiday and other gift payments to South Korean military officers with liquor procurement responsibilities.

The SEC alleged that Diageo and its subsidiaries failed to properly account for these illicit payments in their books and records. Instead, the entities concealed the cash and travel expenses to government officials by recording them as legitimate expenses for third-party vendors or private customers, categorizing them in false or overly vague terms or, in some instances, failing to record them at all. Diageo agreed to pay the SEC $16.4 million in disgorgement, prejudgment interest and a civil penalty.

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3. **International Business Machines Corporation (IBM)**

In March, 2011, International Business Machines (IBM) entered into a settlement with the SEC relating to charges that the company violated the books and records and internal control provisions of the FCPA. The SEC alleged that from 1998 to 2003, employees of IBM Korea, Inc. an IBM subsidiary, and LG IBM PC Co., Ltd., a joint venture in which IBM held a majority interest, provided approximately $207,000 in improper benefits to various government officials in South Korea to secure the sale of IBM products. The SEC also alleged that more than 100 employees of two wholly-owned IBM subsidiaries in China engaged in a “widespread practice” of providing overseas trips, entertainment, and improper gifts to Chinese government officials. These trips involved sightseeing itineraries, and allegedly involved little or no business content. Without admitting or denying the SEC’s allegations, IBM agreed to pay $10 million in civil penalties, disgorgement and prejudgment interest.

4. **Rockwell**

In May 2011, the SEC and Rockwell Automation (Rockwell), a Wisconsin-based manufacturer of industrial products and systems, entered into an administrative settlement to resolve charges that Rockwell’s Chinese subsidiary made improper payments to Chinese state-owned entities to influence purchasing decisions in Rockwell’s favor.

The SEC also alleged that the Chinese subsidiary spent $450,000 on trips not directly related to business purposes for state-owned customers and state design institute employees. These included leisure trips to Germany, Australia, and the US (including New York City, Washington, DC, and Hawaii). The leisure trips typically followed business-related travel. These trips were recorded on Rockwell Automation's books as business expenditures.

Rockwell’s settlement with the SEC consisted of a cease-and-desist order, as well as an agreement to pay over $2.7 million in disgorgement, prejudgment interest and civil penalties. According to Rockwell's public filings, the DOJ notified the company in 2010 that it would not be bringing a criminal enforcement action.

D. **Prosecutions for Violations of the Books and Records and Accounting Provisions**

In 2011, the DOJ and SEC charged several corporations with books and records and accounting violations. As is now widely recognized, violations of these provisions are easily asserted, and can be just as costly, or even more so, than the substantive violation underlying the books and records or accounting charges.

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24 SEC Digest No. D-97.
1. **Magyar Telekom’s ‘Consulting’ and ‘Marketing’ Contract Expenses**

As detailed above in Part B of this section, the DOJ and SEC reached a settlement with Magyar Telekom in December 2011. The SEC charged Magyar with books and records and internal controls violations for disguising payments to legislative officials as “consulting” and “marketing” contracts. Magyar agreed to settle the SEC’s charges through payment of $31.2 million in disgorgement and pre-judgment interest.

2. **Maxwell Technologies’ ‘Special Arrangement’ Expenses**

As detailed in Part A of this section, in the 2011 enforcement action against Maxwell the SEC alleged that Maxwell’s subsidiary violated the books and records provisions of the FCPA by hiding improper payments made to Chinese officials. Specifically, Maxwell’s subsidiary took efforts to mischaracterize invoices using generalized descriptions such as “special arrangement” in order to record the improper payments as legitimate commissions. Maxwell also failed to disclose that much of its revenue and profits were associated with the long-standing scheme, and accounted for the improper payments as sales commission expenses in its financial records.

3. **International Business Machines Corporation’s Invoicing and Recording of Gifts and Travel Expenses**

As part of the enforcement action against IBM, described in Part C above, the SEC charged IBM with violations of the FCPA’s books and records provisions. This allegation was based on the assertion that employees of IBM and its subsidiaries in China and South Korea recorded hundreds of thousands of dollars in improper payments and gifts as legitimate business expenses. Employees also allegedly created fake invoices for “delegation trip requests,” which would allow for advance payment of anticipated travel expenses, and falsely designated “authorized training providers” and submitted fraudulent purchase requests for training services from such providers, all of which were incorrectly recorded in IBM’s books and records.

4. **Facilitating Payments**

Unlike in 2010 with the Noble case, there were no prosecutions in 2011 that challenged the accounting treatment of facilitating payments.

E. **Prosecutions in the M&A Area**

In 2011, the DOJ and SEC continued to pursue enforcement actions against acquiring companies in M&A deals for their subsidiaries post-closing that were perceived not to have

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taken sufficient actions to prevent or curtail their acquired asset from violating the FCPA. These enforcement actions highlight the need for thorough FCPA and regulatory due diligence prior to the consummation of an acquisition and continued post-acquisition diligence and remediation.

1. **Ball Corporation**

   As described in Part B above, in March 2011, Ball Corporation settled FCPA charges with the SEC by agreeing to pay a $300,000 monetary penalty and acquiescing to the entry of a cease-and-desist order.\(^{28}\) Ball had acquired an Argentine company, Formametal S.A., in March 2006, which was accused of making improper payments to Argentine customs officials. The bribes were improperly recorded as legitimate customs fees and business expenses in Formametal’s books and records, but were eventually discovered by Ball accountants. The SEC assessed a fine of $300,000 against Ball Corporation because, while it had voluntarily disclosed the misconduct and cooperated in the related investigation, it did not promptly terminate the employees responsible for the improper payments when it became aware of the violations.

2. **Diageo**

   As described in Part C above, in July 2011 the SEC announced a settlement with Diageo PLC regarding payments made in order to obtain sales, tax, and customs benefits.\(^{29}\) The improper payments alleged against Diageo involved the actions of Diageo’s subsidiaries and joint ventures. In India and South Korea, all payments were made through Diageo’s wholly-owned indirect subsidiary, while in Thailand, a joint venture over which Diageo had operational control was alleged to have retained the government official for assistance in Diageo’s ongoing tax and custom disputes. According to the SEC, Diageo purchased each of the subsidiaries knowing that they had weak compliance systems in place, yet did little to remedy the problems.

3. **Johnson & Johnson**

   In April 2011, Johnson & Johnson settled allegations of FCPA violations at some of its international affiliates. The DOJ and SEC alleged that Johnson & Johnson paid millions of dollars in bribes and improper benefits in order to secure the purchase of its products, and also paid more than $800,000 in kickbacks to the Iraqi government in connection with the United Nations Oil-for-Food Program. According to the government, much of the conduct at issue in the case was undertaken by DePuy International, a supplier of medical devices and recently-acquired subsidiary of Johnson & Johnson. The DOJ alleged that DePuy made the improper payments in Greece, Poland, and Romania, and that Johnson & Johnson was aware that DePuy was involved in such practices prior to its acquisition. Further, the DOJ suggested that Johnson & Johnson became complicit in these payments when it allowed them to continue after purchasing DePuy.

\(^{28}\) *In re Ball Corp.*, SEC Accounting and Auditing Enforcement Release No. 3255 (Mar. 24, 2011); Admin Pro. File No. 3-14305.

\(^{29}\) SEC Digest No. D-100.
In settling the allegations, Johnson & Johnson agreed to a DPA with the DOJ under which it paid a $21.4 million criminal fine. Johnson & Johnson also paid approximately $48.7 million in disgorgement and prejudgment interest to the SEC.

4. **Watts Water**

The Watts Water settlement, described in Part A above, also involved conduct by a recently-acquired subsidiary. Watts Valve Changsha Co. Ltd. (CWV) was a subsidiary that worked almost exclusively with SOEs. The SEC alleged that Watts Water was aware of CWV’s interactions with SOEs, yet failed to implement the internal controls necessary. Of note is the fact that CWV was bound by the Chinese regulations that compel foreign companies to partner with Chinese state-owned enterprises, yet, according to the SEC, Watts Water did little to inform or prepare employees at CWV for the FCPA compliance issues that typically plague subsidiaries acting in such a role.

VI. **Important 2011 Anti-Corruption Developments**

A. **Dodd-Frank Whistleblower Regulations**

In the second half of 2011, the final rule implementing the whistleblower bounty provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) went in effect. The Final Rule, issued by the SEC in May 2011, implemented provisions in the Act that require the Commission to award a bounty to eligible whistleblowers in cases where enforcement actions include monetary sanctions collected above US$1 million and a whistleblower has made a qualifying report to the Commission. In particular, the Commission must award a whistleblower a bounty of between 10% and 30% of the monetary sanctions in actions brought by the Commission and related actions brought by certain other authorities. Our previous alert on the Final Rule is available at [http://www.steptoe.com/publications-newsletter-206.html](http://www.steptoe.com/publications-newsletter-206.html)

For corporations, the most significant aspect of the Final Rule is what it does not require—whistleblowers are not required to report wrongdoing internally within the company as a condition to being eligible for an award. Instead, the Final Rule allows whistleblowers to decide whether to report internally first, and allows the SEC to consider any internal reporting as a factor that may warrant a larger bounty. The absence of an internal reporting requirement in the Final Rule means companies must be ever vigilant to ensure that their compliance programs are effective in preventing and detecting FCPA issues, including encouraging internal reporting.


The Final Rule also continues to raise questions over the ability of companies to obtain cooperation credit in the event of an FCPA enforcement action by the SEC based upon a whistleblower report. Under the policy formalized in 2001 in the Commission’s Seaboard report, voluntary self-reporting by the company is a factor determining the level of credit a company may receive in an SEC action. Yet, under the Final Rule, a company’s self-report could come promptly, but still at a time when, unbeknownst to the company, a whistleblower has already made a report to the SEC.

The Act also included new anti-retaliation provisions for whistleblowers, which expanded on existing protections under the Sarbanes-Oxley Act (SOX) in important ways. Unlike the SOX protections, the new protections allow for a private right of action and also, according to the Final Rule, allow for enforcement by the SEC. In addition, the new protections explicitly cover personnel of foreign subsidiaries – who are often on the front line of FCPA issues. Litigation under the anti-retaliation provisions of the Act has already begun, including in the FCPA area. See Asadi v. G.E. Energy (USA), LLC, Case No. 12cv345 (S.D.Tex. Compl. filed Feb. 3, 2012) (concerning the firing of the country executive for Iraq in mid-2011 after he allegedly objected to his company’s hiring of a close associate of a senior Iraqi official).

The Final Rule is still in its early months, without a clear indication of its final impact. In November 2011, the SEC issued its first report to Congress concerning the whistleblower program, which covered the nearly first two months (from early August through September 2011) after the rule took effect. In that time, the Commission received 13 tips on FCPA matters. It also received 32 reports from foreign persons, mostly in Europe and China, though the SEC did not specify which of these reports related to the FCPA. On an annualized basis, the number of whistleblower reports in those first two months was considerably lower than the number of reports estimated in the Final Rule. Nonetheless, the Chief of the Commission’s Office of the Whistleblower observed in late 2011 that the quality of the reports was high. By the next report to Congress in late 2012, a better picture of FCPA tips being generated may begin to emerge, though the impact on enforcement actions—which take significant time for the Commission to develop—may be several years away.

B. UK Bribery Act

Another highly anticipated development in the anti-corruption world was the entry into force of the UK Bribery Act of 2010 (Bribery Act) on July 1, 2011. Thus far, there has been only one prosecution under the Bribery Act, as described below. However, the Serious Fraud Office (SFO) has publicly stated that it takes fraud seriously and intends to enforce the Bribery Act. 2012 will see a new head of the SFO succeed Richard Alderman, and may provide the SFO with opportunities to clarify some of the many questions that continue to surround the Bribery Act’s jurisdictional and substantive scope.

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1. Overview of First Prosecution under The Act In 2011

The only prosecution (and conviction) under the Bribery Act since it came into force was of an individual, Munir Patel, a public official and a former Magistrates’ Court administrative officer. He was sentenced to six years in prison after pleading guilty to the Section 2 offense of requesting or receiving a bribe with the intention of improperly performing his functions, together with committing the common law offence of Misconduct in Public Office. Mr. Patel admitted to taking a £500 bribe from an individual in exchange for keeping details of a traffic summons off the court database.

2. Implications

Gaon Hart, Senior Crown Advocate for the Crown Prosecution Service Special Crime and Counter Terrorism Division, said:

This prosecution is the first of its kind under the Bribery Act 2010 which has provided a significant weapon in the armoury of prosecutors that enables us to focus on the bribery element rather than general misconduct behaviour. We will continue to target those who act corruptly purely for personal gain and tailor the charge to reflect their wrong-doing.\(^3\)

Given that the Bribery Act does not have retrospective effect, it is unsurprising that only one prosecution has been brought in the six months since the Act came into force. For corruption crimes that have taken place pre-Bribery Act, the SFO and the Crown Prosecution Service (CPS) continue to take action against offenders pursuant to the previous laws. Some examples of these high-profile cases include the proceedings brought against Mabey & Johnson early in 2011 and subsequently against M.W. Kellogg in February 2011.

In the meantime, the SFO has candidly acknowledged that the new laws created by the Bribery Act are yet to be fully understood by the corporate world and it has indicated its consequent focus will be assisting companies to bring their internal compliance programs in line with their responsibilities.\(^4\)

However, despite what might seem like a soft approach, the Director of the SFO has also made it clear that the other part of the SFO’s strategy is to “find out and bring to justice those who have no intention of complying with the law and indeed want to continue to use corruption”.\(^5\) In light of this goal, the SFO and CPS appear to be sending a clear message: co-


\(^4\) SFO press release (undated) “International Anti-corruption Day: an overview of what the SFO has done in 2011”.

\(^5\) Speech by Richard Alderman on 9 February 2012 at the CBLF Global Business Leaders Dinner, Beijing.
operation with a view to combating corruption is looked upon favorably but palpable offenders will be brought to justice. It will be interesting to see how, as corrupt behavior continues to be uncovered, what approach CPS and SFO will use to address the incidents.

C. **China Anti-Bribery Developments**

On May 1, 2011 China amended the anti-bribery provisions of the PRC Criminal Code. In addition to prohibiting commercial bribery and the bribery of Chinese state functionaries, Chinese law now prohibits “giving” “property” to “any foreign public official or official of an international public organization” “for the purpose of seeking illegitimate commercial benefits.”

The PRC Criminal Code applies to all PRC citizens, wherever located, all natural persons in the territory of PRC regardless of nationality, and all companies, enterprises, and institutions registered under PRC law. Wholly-owned foreign enterprises and non-PRC companies with representative offices in China also fall within the scope of the new prohibitions. Violators of the new prohibition will be subject to the same punishments as for the existing proscriptions on bribery: (1) criminal detention of not more than three years imprisonment for “moderate” sized bribes or (2) three to ten years imprisonment and a fine for larger bribes.

The PRC appears to have inserted this new element of criminal law in an attempt to comply with its obligation under the UN Convention against Corruption. The Convention, however, calls for a broad set of elements to appear in legislation to criminalize bribery, and many appear missing from the new Chinese law. Additionally, the law defines none of its key terms. The law explicitly prohibits giving bribes, but does not mention offering, promising or authorizing the payment of bribes. It makes no reference to “indirect” bribery, and therefore does not provide indications as to the liability a principal might have for its agents, consultants or other third-party representatives. It sanctions transfers of “property,” without defining whether this would also include immaterial benefits, such as jobs, promotions, or personal services. Conversely, the new law does not appear to contain any affirmative defenses or exceptions.

We have not identified any published guidelines on the PRC anti-bribery amendments. In light of the questions left open by the new law, parties subject to its jurisdiction will need to closely monitor the first few cases brought by the Chinese authorities.

D. **World Bank**

While US enforcement activity in 2011 did not reach prior years’ peaks, World Bank enforcement activity reached an all-time high and 2012 shows no signs of abatement. Spurred by the addition of settlement authority in late 2010, the World Bank has debarred 63 firms and individuals thus far in fiscal year 2012 from 28 countries. With the advent of cross-debarment

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36 Amendment VIII to the Criminal Law of the People’s Republic of China, Order of the President of the People’s Republic of China No.41, 2011 China Law LEXIS 714 (Feb. 25, 2011, effective May 1, 2011).

37 The World Bank fiscal year runs from July 1 through June 30.
in 2010, the World Bank has cross-debarred 14 entities with other international financial institutions thus far in fiscal year 2012. The World Bank also stepped up its practice of making referrals to national authorities where its investigations found evidence of violations of national laws. These referrals contribute to the increasing instance of multi-jurisdictional cases and complexity in this area.

VII. Conclusions

2011 was another active year in the universe of anti-corruption led again by US enforcement. While US aggregate fines were down significantly from 2010, this should not be viewed as de-emphasis on the FCPA or its enforcement. Instead, it should be viewed as a consequence of a culmination of a series of large 2010 settlements that had been in the works for years as well as the DOJ’s probable preoccupation with four FCPA-related trials. The SEC also saw a change of leadership in its FCPA unit, as Kara Brockmeyer succeeded Cheryl Scarboro as the unit head.

The 2011 trials demonstrate the difficulty of proving FCPA violations at trial, and rightfully so. The year saw judges and juries hold the government to the high standard of proving each element beyond a reasonable doubt and conducting themselves in accordance with ethical standards. It remains to be seen what long-term effect the government’s failure to obtain convictions will have on FCPA-related litigation and settlements in the future.

In 2012, we can expect additional jurisprudence on the definition of government “instrumentality” and whether or not employees of SOEs should be considered foreign officials under the FCPA. Most notably, we can look forward to a likely discussion of the SOE issue in Lindsey by the US Court of Appeals for the Ninth Circuit.

Although 2011 did not produce any legislative changes to the FCPA, it did produce an undertaking by the DOJ to issue new guidelines in 2012. How much these guidelines will provide by way of clarity and true guidance will remain to be seen.

Finally, we should anticipate continued aggressive anti-corruption enforcement and cooperation between the US government and other national and non-governmental enforcement agencies. Increased enforcement by other nations may or may not affect the decision of US authorities to seek enforcement actions of their own, but they certainly are likely to maintain a heightened awareness of anti-corruption and anti-corruption related issues into the foreseeable future.

Lucinda Low, William Gordon, Monica Ager, Owen Bonheimer, Michael Lieberman, Lauren Groth, Elisabeth Page, Berengere Parmly and Jeanne Cook contributed to this report. For further information please feel free to contact them or any member of Steptoe’s FCPA and Anti-Corruption Practice Group, in Washington, D.C., New York, London, Brussels, or Beijing.
## APPENDIX: Table of 2011 Cases, by Element

<table>
<thead>
<tr>
<th>Anti-Bribery Provisions: Substantive Elements</th>
<th>Case</th>
</tr>
</thead>
</table>
| • Officials Involved                        | • Foreign officials of Costa Rica, Egypt, Vietnam, Indonesia, the United Arab Emirates, Myanmar, and Bangladesh in direct positions to influence insurance contracts (*Aon*)  
|                                              | • U.N. procurement official (*Armor*)  
|                                              | • Argentine officials in a position to influence customs decisions (*Ball*)  
|                                              | • Officials employed at state-owned customers in various Latin American countries, including PEMEX in Mexico, in a position to influence contract procurement (*Bridgestone*)  
|                                              | • Individuals connected to OTE, a telecommunications provider based in Athens, Greece that is partially owned by the Greek Government (*Comverse*)  
|                                              | • Employees of government owned liquor stores in India (*Diageo*)  
|                                              | • Government officials in India with influence on liquor label registrations (*Diageo*)  
|                                              | • Thai government official with lobbying influence (*Diageo*)  
|                                              | • South Korean customs official (*Diageo*)  
|                                              | • South Korean and Chinese officials with influence on procurement decisions (*IBM*)  
|                                              | • Officials within the executive branch of the Government of Nigeria, officials of the Nigerian National Petroleum Corporation and officials of Nigeria LNG Limited (*JGC*)  
|                                              | • Physicians and administrators at state run hospitals in Greece, Poland and Romania (*Johnson & Johnson*)  
|                                              | • Iraqi officials related to Oil for Food Program (*Johnson & Johnson*)  
|                                              | • Macedonian political parties (*Magyar Telekom*)  
|                                              | • Macedonian government officials with responsibility related to telecommunications laws and regulations (*Magyar Telekom*)  
|                                              | • Employees of a Chinese state-owned electric utility infrastructure manufacturer (*Maxwell*) |
| **Employees of OJSC O’ztashqineftgaz, an oil and gas producer owned by the Uzbekistani government (Tenaris)** |
| **Mexican veterinarians whose certifications were required to export chicken products (Tyson Foods)** |
| **Employees of government owned design institutes (Watts Water and Rockwell)** |
| **Third Parties Involved, if any** |
| **Third-party facilitators (Aon)** |
| **Sales agents (Armor, Bridgestone, Converse, JGC, Johnson & Johnson, Tenaris)** |
| **Distributors (Johnson & Johnson)** |
| **Consultants who passed money from sham contracts to Macedonian officials (Magyar Telekom)** |
| **Third party intermediaries (Maxwell)** |
| **Value Provided** |
| **$3.6 million (Aon)** |
| **$4.6 million (Armor)** |
| **$106,749 (Ball)** |
| **$2 million (Bridgestone)** |
| **$536,000 (Converse)** |
| **$2.7 million (Diageo)** |
| **$207,000 (IBM)** |
| **$180 million (JGC)** |
| **$16.4 million (Johnson & Johnson)** |
| **$6 million (Magyar Telekom)** |
| **$2.5 million (Maxwell)** |
| **$450,000 (Rockwell)** |
| **$260,000 (Tyson Foods)** |
| **$8.9 million (Tenaris)** |
| **$2.7 million (Watts Water)** |
| **Action, Inaction, Influence or Advantage Sought:** |
| **Payments to secure risk management, insurance, and reinsurance contracts in Bangladesh, Costa Rica, Egypt, Indonesia, Myanmar, the United Arab Emirates, and Vietnam (Aon)** |
| **Payments to ensure that U.N. body armor contracts would be awarded (Armor)** |
| **Payments to induce state customs officials to circumvent Argentine laws prohibiting the importation of used equipment and parts (Ball)** |
| **Payments to secure contracts for sales of industrial products, including marine hoses (Bridgestone)** |
| Payments in order to obtain business from an SOE (Comverse) |
| Payments to government officials to obtain sales and tax benefits (Diageo) |
| Payments and improper gifts and payments of travel and entertainment expenses to secure the sale of products (IBM) |
| Payment to obtain four contracts to build LNG facilities on Bonny Island, Nigeria (JGC) |
| Payments to secure purchase products and to receive kickbacks from the Oil-for-Food program (Johnson & Johnson) |
| Payments to influence Macedonian government officials to delay certain regulatory actions (Magyar Telekom) |
| Payments to influence purchasing decisions (Rockwell) |
| Payments to get approval from Mexican veterinarians whose certifications were required to export chicken products (Tyson Foods) |
| Payments to obtain competitors’ bid information, which it used to secretly submit revised bids to its advantage (Tenaris) |
| Payments to influence the recommendation of CWV’s products and creation of design specifications that favored CWV products (Watts Waters) |

<p>| Books and Records Violations |
| Aon |
| Armor |
| Ball |
| Comverse |
| Diageo |
| IBM |
| JGC |
| Magyar Telekom |
| Maxwell |
| Rockwell |
| Tenaris |
| Tyson Foods |
| Watts Water |</p>
<table>
<thead>
<tr>
<th><strong>Internal Control Issues</strong></th>
<th><strong>Combined Total Fines and Penalties</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Aon</td>
<td>• $16.2 million (Aon)</td>
</tr>
<tr>
<td>• Armor</td>
<td>• $15.99 million (Armor)</td>
</tr>
<tr>
<td>• Ball</td>
<td>• $300,000 (Ball)</td>
</tr>
<tr>
<td>• Diageo</td>
<td>• $28 million (Bridgestone)</td>
</tr>
<tr>
<td>• IBM</td>
<td>• $2.8 million (Comverse)</td>
</tr>
<tr>
<td>• Maxwell</td>
<td>• $16.4 million (Diageo)</td>
</tr>
<tr>
<td>• Rockwell</td>
<td>• $218.8 million (JGC)</td>
</tr>
<tr>
<td>• Tenaris</td>
<td>• $70 million (Johnson &amp; Johnson)</td>
</tr>
<tr>
<td>• Tyson Foods</td>
<td>• $95.1 million (Magyar Telekom)</td>
</tr>
<tr>
<td>• Watts Water</td>
<td>• $14 million (Maxwell)</td>
</tr>
<tr>
<td></td>
<td>• $2.7 million (Rockwell)</td>
</tr>
<tr>
<td></td>
<td>• $5.2 million (Tyson Foods)</td>
</tr>
<tr>
<td></td>
<td>• $8.9 million (Tenaris)</td>
</tr>
<tr>
<td></td>
<td>• $3.776 million (Watts Water)</td>
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</tbody>
</table>
### Anti-Bribery Provisions: Jurisdictional Elements

<table>
<thead>
<tr>
<th>Case</th>
<th>• Dd-1 or dd-2 territoriality</th>
</tr>
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<tbody>
<tr>
<td>Aon</td>
<td></td>
</tr>
<tr>
<td>Armor</td>
<td></td>
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<tr>
<td>JGC</td>
<td></td>
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<tr>
<td>Johnson &amp; Johnson</td>
<td></td>
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<tr>
<td>Magyar Telekom</td>
<td></td>
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<tr>
<td>Maxwell</td>
<td></td>
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<tr>
<td>Tenaris</td>
<td></td>
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<tr>
<td>Tyson Foods</td>
<td></td>
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<tr>
<td>• Dd-3 territoriality</td>
<td></td>
</tr>
<tr>
<td>Bridgestone</td>
<td></td>
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</tbody>
</table>

### Accounting Provisions: Books and Records Elements

<table>
<thead>
<tr>
<th>Case</th>
<th>• Nature of Alleged Inaccuracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Falsely and vaguely recorded payments with generic descriptions and did not disclose or itemize leisure and non-business related activities (Aon)</td>
<td></td>
</tr>
<tr>
<td>Created false and misleading journal entries to facilitate illegal action, used intermediaries to obscure source and destination of the funds, and mischaracterized bribes as ordinary business expenses (Armor)</td>
<td></td>
</tr>
<tr>
<td>Inaccurately recorded the payment as “Advice fees for temporary merchandise exported” in an “Other Expenses” account. (Ball)</td>
<td></td>
</tr>
<tr>
<td>Inaccurately recorded bribes as commissions (Comverse)</td>
<td></td>
</tr>
<tr>
<td>Used slush funds at travel agencies to pay for unauthorized overseas trips by government officials, created false invoices for trips. (IBM)</td>
<td></td>
</tr>
<tr>
<td>Nature of Resolution: DOJ</td>
<td>Case</td>
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<tr>
<td>--------------------------</td>
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</tr>
<tr>
<td>• Plea (Parent or Subsidiary)</td>
<td>• Bridgestone</td>
</tr>
</tbody>
</table>
| • Deferred Prosecution Agreement | • JGC  
  • Johnson & Johnson  
  • Magyar Telekom  
  • Maxwell  
  • Tyson Foods |
| • Non-Prosecution Agreement | • Aon  
  • Armor  
  • Comverse  
  • Tenaris |
<p>| • Monitor | • JGC |</p>
<table>
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<tr>
<th>Nature of Resolution: SEC</th>
<th>Case</th>
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<tr>
<td>• Consent Decree</td>
<td>• Aon</td>
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<tr>
<td></td>
<td>• Armor</td>
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<td>• Comverse</td>
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<td>• IBM</td>
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<td></td>
<td>• Johnson &amp; Johnson</td>
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<td></td>
<td>• Magyar Telekom</td>
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<td></td>
<td>• Maxwell</td>
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<td></td>
<td>• Tyson Foods</td>
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<tr>
<td>• Injunction</td>
<td>• Aon</td>
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<tr>
<td></td>
<td>• Armor</td>
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<tr>
<td></td>
<td>• Comverse</td>
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<td>• IBM</td>
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<td>• Johnson &amp; Johnson</td>
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<td>• Magyar Telekom</td>
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<td></td>
<td>• Maxwell</td>
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<td></td>
<td>• Tyson Foods</td>
</tr>
<tr>
<td>• Deferred Prosecution Agreement</td>
<td>• Tenaris</td>
</tr>
<tr>
<td>• Cease and Desist Order</td>
<td>• Ball</td>
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<td></td>
<td>• Diageo</td>
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<td></td>
<td>• Rockwell</td>
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<td>• Watts Water</td>
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Recent UK Enforcement Actions Highlight Broad Range of UK Anti-Corruption Laws

August 22, 2011

The UK’s Bribery Act 2010 came into force on 1 July 2011, following a long period of government consultation.[1] However, UK authorities have been bringing enforcement actions with some regularity over the last two years, employing a variety of different tools. Two recent UK enforcement actions, summarised in this alert, highlight the different legal strategies available to UK authorities to bring penalties against individuals and companies for corruption-related infractions, separate from the Bribery Act. These strategies will continue to be available alongside the new Bribery Act, and thus must be taken into account by companies that carry on business in the UK when evaluating the nature and scope of their UK anti-corruption risk exposures and compliance programs.

FSA £6.9 Million Fine Against Willis Limited

On 21 July 2011 the UK Financial Services Authority (“FSA”) imposed an administrative fine of £6.895 million on UK insurance broker Willis Limited, arising from alleged failures on the part of Willis to maintain an effective anti-corruption compliance program. The penalty was imposed pursuant to the Financial Services and Markets Act 2000 (“FSMA”), and associated regulations. The FSMA applies to financial services providers, including banks and insurers who are regulated by the FSA.

Section 206(1) of the FSMA provides that:

“If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act… it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.”

The Willis action represents the second case where the FSA has brought an enforcement action for deficiencies in anti-corruption compliance programs, following the FSA’s £5.25 million fine against Aon Limited in January 2009, and is one of the largest FSA fines on record.[2] The ultimate fine against Willis reflected a 30% discount under the FSA’s executive settlement procedures, in recognition of Willis’s active cooperation with the FSA and its agreement to settle the matter early in the FSA’s investigation.

The FSA exercised its enforcement authority in the Willis matter under section 206(1) of the FSMA, which provides that:

“If the [FSA] considers that an authorised person has contravened a requirement imposed on him by or under this Act… it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.”

The FSA determined that Willis Limited had breached the following:

- Principle 3 of the FSA’s Principles for Businesses[3], which provides that:
  “A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”; and
Recent UK Enforcement Actions Highlight Broad Range of UK Anti-Corruption Laws

- The FSA’s Senior Management Arrangements, Systems and Controls[4] sourcebook which provides that:

“A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.”

The FSA found that between January 2006 and December 2009 Willis made payments totalling £27 million to overseas third party sales representatives, who assisted Willis in winning and retaining business from overseas clients, particularly in high-risk corruption jurisdictions. The FSA found that Willis failed to implement several anti-corruption safeguards in connection with those third parties, and in particular:

1. Willis did not adequately document the services provided by some of its external providers with only brief descriptions in support of commission payments being given in many cases (such as “introducer” or “producing broker”);
2. Willis did not ensure that adequate due diligence was carried out on third party representatives to evaluate the corruption risks that the role might entail, particularly in high-risk jurisdictions;
3. Willis did not regularly review its relationships with its sales representatives to confirm whether it was necessary and appropriate to continue the relationships; and
4. Willis did not adequately train staff on anti-corruption issues, or ensure that improved anti-bribery and corruption policies and guidance, introduced by the company in August 2008, were fully implemented.

Notably, the FSA did not conclude that Willis had acted in a deliberate or reckless manner. However, given that Willis would have been aware of bribery and corruption risks associated with making payments to obtain or retain business, particularly in high-risk jurisdictions, the FSA found that additional steps should have been taken to monitor the adequacy of procedures. The FSA noted, in particular, that Willis was on notice of the risks of failing to maintain adequate compliance programs given the FSA’s “Dear CEO” letter to the insurance brokering industry in November 2007 (which highlighted the corruption risks that insurance brokers face), and the FSA’s January 2009 fine against Aon Limited.

On the other hand, the FSA acknowledged that Willis has taken steps to address the alleged deficiencies in its program, and the FSA also recognized the company’s efforts to conduct a thorough internal review of its past payments to third-party representatives in conjunction with its remedial efforts. Those and other factors contributed to the 30% penalty reduction assessed by the FSA under its executive settlement procedures.


In an unrelated matter, on 22 July 2011 the UK Serious Fraud Office (“SFO”) settled an enforcement action against Macmillan Publishers Limited (“MPL”), resulting in a High Court order for MPL to pay £11.3 million in a civil recovery action, under Part 5 of the Proceeds of Crime Act 2002. The civil
recovery is in recognition of sums which MPL allegedly received through bribery-related misconduct relating to sales of educational products in East and West Africa.

The SFO’s initial enquiry arose following a World Bank investigation into allegations of corruption by MPL in connection with sales in a World Bank-financed project in Sudan. The World Bank debarred MPL for three years from participating in Bank-financed projects under the World Bank’s Sanctions Procedures.

The SFO-mandated review was, notably, considerably broader than the World Bank investigation (which focused only on World Bank financed projects). The SFO required MPL to conduct a broad internal review of its books and records – at the company’s own expense – with a view toward identifying corruption-related risks. The first phase of the SFO-mandated review led to a further, more detailed review of three jurisdictions – Rwanda, Uganda, and Zambia – where potential bribery and corruption risks were evident. Throughout the process, the SFO worked in collaboration with the World Bank, as well as the City of London Police.

In view of evidence disclosed through the MPL investigations, the SFO concluded that certain of the contract awards (which often were conducted through public tenders) were “susceptible to improper relationships being formed and corruption taking place”. The SFO thus concluded that MPL may have received revenue that had been derived from unlawful conduct. Accordingly, although the SFO findings may not have supported a prosecution under the existing UK anti-bribery laws, the SFO elected to pursue a civil recovery under Part 5 of the Proceeds of Crime Act, which provides a broad authority to recover, in a civil action, property that represents the proceeds of unlawful conduct.

The SFO took into account a number of factors in determining its position on settlement with MPL:

1. MPL cooperated fully with the SFO and other authorities including the World Bank;
2. Once informed of the allegations of corruption, MPL responded appropriately by reviewing its internal anti-bribery and corruption policies and engaging external consultants to assist in the implementation of these policies;
3. The SFO recognized the World Bank’s decision to debar MPL, as well as MPL’s decision voluntarily to cease all live and prospective public tenders in its Education Division in East and West Africa, and the loss of prospective revenue which this caused.

The SFO settlement included a requirement that, for a period of one year, MPL submit to an external monitor, who will report to both the SFO and the World Bank. This is consistent with the SFO’s tendency in other recent enforcement actions to require an independent monitor as part of corruption-related settlements.

Strikingly, according to the SFO press release announcing the MPL action, the SFO spent only £27,000 in pursuing enforcement against MPL. This sum highlights the SFO’s potential to leverage internal investigatory work by companies in achieving enforcement results, and will be cold comfort to many commentators, who have suggested that the SFO’s limited enforcement budget for Bribery Act cases (approximately £2 million per year) will inhibit the SFO’s ability to enforce UK anti-corruption laws.

Conclusions

The Willis and MPL enforcement actions are informative in four respects:

Recent UK Enforcement Actions Highlight Broad Range of UK Anti-Corruption Laws
Multiple Statutory and Regulatory Enforcement Tools. Both the FSMA and the Proceeds of Crime Act provide administrative or civil enforcement alternatives, with potentially broader standards and lower evidential thresholds than the Bribery Act (which is a criminal statute). Much attention has been given in recent months to parsing the provisions of the Bribery Act in relation to potential corporate liabilities. Although those discussions are certainly important, companies should not lose sight of the fact that other statutes are available to UK enforcement authorities to penalise corruption-related activity.

Internal Controls Requirements. The Willis action in particular illustrates the importance of implementing and maintaining anti-bribery policies and controls. Although the Bribery Act does not expressly require companies to implement internal controls (in contrast to the U.S. Foreign Corrupt Practices Act, which contains books and records requirements for publicly-traded companies), FSA Principle 3 does contain an affirmative internal controls requirement. Even companies which are not in the financial sector (and thus are not regulated by the FSA), accounting controls requirements exist in the general UK corporate laws (such as the Companies Act) and could be used to support enforcement actions.

Guidance on Best Practices. The FSA’s Final Notice in Willis provides a detailed discussion of the FSA’s views on what a compliance program should include (in particular, in the context of third-party due diligence and monitoring). Accordingly, although the FSA notice does not address the Bribery Act, it can serve as useful guidance for UK companies which are seeking to develop their anti-corruption compliance programs (complementing the UK Ministry of Justice’s Bribery Act “adequate procedures” guidance, issued in March 2011).

World Bank / International Financial Institution Enforcement and Referral Risk. The MPL enforcement action arose following a World Bank investigation and referral. The World Bank and other international financial institutions have been increasingly active in investigating corruption-related misconduct in contracts which those institutions finance, with significant consequences for breaches, including long debarment periods, cross-debarment by other international financial institutions, and (as the MPL case highlights) national enforcement authority actions.

If you have any questions concerning this alert, please contact David Lorello (dlorello@steptoe.com; +44 20 7367 8007), Fiona Laurence (flaurence@steptoe.com; +44 20 7367 8093) or Sheena Sheikh (ssheikh@steptoe.com; +44 20 7367 8002) in Steptoe’s London office.


[4] SYSC 3.2.6R
Racing to a Locked Door? SEC Issues Final Whistleblower Bounty Rule and Announces First Deferred Prosecution Agreement, Revealing Competing Incentives for Corporate Self Reporting

June 7, 2011

On May 25, 2011, the US Securities and Exchange Commission (the “Commission” or the “SEC”) issued its final rule implementing the whistleblower bounty provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). See Pub. L. 111-203 (July 21, 2010) § 922 (codifying whistleblower bounty provisions into Section 21F of the Securities Exchange Act of 1934); SEC Rel. No. 34-64545 (May 25, 2011) (the “Issuing Release,” including at 241-79 the “Final Rule”). The Final Rule implements provisions in the Act that require the Commission to award a bounty to eligible whistleblowers in cases where enforcement actions include monetary sanctions collected above $1 million and a whistleblower has made a qualifying report to the Commission. In particular, the Commission must award a whistleblower bounty of between 10% and 30% of the monetary sanctions in the Commission enforcement action and related enforcement actions.

For corporations, the most significant aspect of the Final Rule is what it does not require—whistleblowers are not required to report wrongdoing internally within the company as a condition to being eligible for an award. After the rule proposed in November 2010 (the “Proposed Rule”) did not include such a requirement, many companies from a wide range of industries submitted written comments to the SEC expressing concerns that the absence of such a requirement would undercut companies’ internal compliance programs. Despite these comments, the Commission declined to take this approach. Instead, the Commission, building on the approach in the Proposed Rule, included some additional incentives it believed would encourage internal reporting.

Because the Final Rule allows whistleblowers to go directly to the Commission, it raises a question left unanswered in the Issuing Release as to whether a company can still receive credit under Seaboard for independently discovering and voluntarily reporting wrongdoing to the Commission where, unbeknownst to the company[1], a whistleblower has already made a report. Under the policy formalized in 2001 in the Commission’s Seaboard report, voluntary self-reporting is a factor determining the level of credit a company may receive in a Commission action.[2] Under Seaboard, the degree of credit can range “from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents [used] to announce and resolve enforcement actions.”[3]

In practice, self-reporting has become a requirement if a company is to have any hope of avoiding an enforcement action or civil penalty.[4] As discussed later in this alert, the Commission’s failure to adequately explain the ways in which the existence, timing, and type of a whistleblower report will impact a company’s ability to claim credit for self-reporting (and what benefits will flow from that self-report) may push companies to one of two extremes—causing companies to hastily self-report even the most minor of concerns to the Commission staff, or causing companies to avoid self-reporting altogether.[5]

Yet the Commission’s failure to address these questions goes much further and calls into question the viability of certain of the Commission’s cooperation initiatives announced in early 2010. Under these initiatives, the Commission has sought to motivate and reward cooperation by allowing cases to be resolved outside of enforcement proceedings, through settlements in non-prosecution (“NPAs”) and
deferred-prosecution agreements ("DPAs"). In its late 2010 announcement of its first NPA—with Carters, Inc. in a financial fraud case with no monetary penalty—the Commission highlighted Carter’s “prompt and complete self-reporting.” SEC Press Rel. 2010-252 (Dec. 20, 2010). Similarly, in the Commission announcement in mid-May of this year of its first DPA—with Tenaris S.A. (“Tenaris”) in a Foreign Corrupt Practices Act (“FCPA”) case—the Director of the SEC’s Division of Enforcement highlighted “[t]he company’s immediate self-reporting” as a factor determining the outcome. SEC Press Rel. 2011-112 (May 17, 2011). Whether either a NPA or a DPA is possible in the event a whistleblower is first to the Commission’s or company’s door is nowhere addressed in the Commission’s Issuing Release.

After reviewing the Tenaris case, we will return to the whistleblower Final Rule, discussing both the contours of the Final Rule and exploring its likely impact in the current enforcement environment, particularly in the FCPA area.

SEC Announces First DPA, in an FCPA Case with Tenaris

On May 17, 2011, the Commission announced that it had entered into a DPA with Tenaris, a Luxembourg-based global supplier of steel tubes and related services whose shares are traded on the New York Stock Exchange. This is the first DPA entered into by the Commission since its early 2010 announcement that DPAs would be available to incentivize and reward cooperation.[6] Under the DPA, the Commission agreed to forgo filing a civil action against Tenaris for violations of the anti-bribery and accounting (internal controls and books and records) provisions of the FCPA in connection with its business activities in Uzbekistan in 2006 and 2007, provided that Tenaris complies with the terms and conditions of the two-year DPA.

Under the terms of the DPA, Tenaris agreed to pay $5.4 million in disgorgement and interest to the Commission, and to pay a $3.5 million criminal penalty under a separate two-year non-prosecution agreement entered into with the US Department of Justice (“DoJ”). Tenaris also agreed to further cooperate with the ongoing Commission investigation and to report any informal or formal complaint against Tenaris relating to any anti-bribery or securities law, regulation, or rule. Tenaris further agreed to implement due diligence requirements related to the retention and payment of agents; to carry out annual reviews of its compliance program; to secure periodic certifications of compliance with its Code of Conduct by directors, officers, and management; and to carry out “effective” anti-corruption training of personnel whose activities are relevant to FCPA compliance.

Alleged Bribery in Uzbekistan

The DPA (at ¶¶ 6d-y) highlighted a scheme under which Tenaris made payments to an agent in connection with efforts to win business from the Uzbekistan state oil company. Tenaris agreed to pay an agent in Uzbekistan a 3.5% commission after the agent provided confidential bid information from officials of the state enterprise. (The extent of due diligence on the agent was not described by the Commission.) Based in part on the information provided by the agent, the company was able to fashion its bids and win several contracts. The DPA alleges that the company “understood” that a portion of funds would be paid to officials at the state enterprise subsidiary. The DPA does not cite conduct by a person while within the United States; instead, it states that Tenaris paid the agent “through an intermediary bank” in New York. (E-mails from company sales personnel further indicated an alleged agreement to pay Uzbek officials to prevent an investigation of the leaking of confidential bid
information.) Based on the foregoing, the DPA referred to alleged violations of the anti-bribery and accounting provisions of the FCPA.  

Tenaris’ Response to Reports of Wrongdoing, and Implications of the SEC DPA

According to the DPA and Tenaris’ disclosures, in March 2009, the company received a report from a customer in Central Asia that a sales agent may have made improper payments to customer employees. DPA ¶ 6z; Tenaris Form 6-K (May 7, 2011). The company’s Audit Committee commissioned an internal investigation, which included a worldwide review of its internal control system. The company made a disclosure to the Commission and the DoJ. See DPA ¶¶ 6z-bb. The DPA (¶ 6bb) characterized this disclosure as “timely, voluntary, and complete.”[7]

The resolution with Tenaris highlights several features of DPAs that may make them an attractive tool for companies seeking to resolve FCPA matters with the SEC on favorable terms. Most significantly, the DPA can carry a lesser “stigma” than an administrative or judicial action. A company with a DPA can report that it has not been subject to an “enforcement action.” Unlike in an administrative or judicial action, with a DPA there is no cease-and-desist order or injunction associated with a resolution. This reduces the stakes in the event that the company faces enforcement action in the future. In Tenaris, the company did agree, however, to refrain from violating the securities laws for the two-year term of the DPA. See id. ¶ 7a. Also, the SEC DPA in Tenaris, like Commission judicial and administrative actions, was settled on a “no admit or deny” basis. Tenaris was not required to admit the allegations in the DPA,[8] which may allow it to preserve defenses in a collateral civil action, such as a shareholder derivative suit. A “no admission” DPA also may decrease the chances that companies doing business with governments or in projects funded by international financial institutions would face cross-debarment based upon the DPA. This feature of the SEC’s first DPA stands in contrast with DPAs entered into with the DoJ, which generally require the defendant to admit to a statement of facts filed with the court and which cannot be contested even in collateral proceedings.[9]

At the same time, however, DPAs may be a device to further ratchet up compliance expectations on companies. Not only can the DPA be used to impose detailed compliance program expectations (such as compliance training obligations specified in the Tenaris DPA), but the availability of a DPA also could increase the number of Commission cases, including FCPA cases. Whereas the Commission may not previously have taken an enforcement action in a given case, Commission staff now can seek a DPA. In so doing, the Commission could avoid potential litigation risks over its legal theory or its jurisdictional theory. For example, the Tenaris DPA does not establish the basis for the Commission allegation that Tenaris “understood” that a pass-through payment would be made to an official from a commission of merely 3.5%. The Tenaris DPA also does not clearly establish a purposeful use of interstate commerce within the United States, beyond the alleged routing of a payment through a US account (which may have been merely an inter-bank clearing account for US dollar transactions). By resolving the case through a DPA, the Commission is able to avoid scrutiny of these aspects of the case.

Whistleblower Rule

Less Restrictive Eligibility Criteria

Under the Final Rule, the Commission is required to grant a whistleblower award to an individual who voluntarily provides original information to the Commission leading to successful Commission enforcement action in which total monetary sanctions exceed $1 million.[10] These overall criteria have
not changed since the Proposed Rule. (For background on the Proposed Rule, see Steptoe Alert.) The Final Rule does, however, make significant changes to how some of these eligibility criteria are defined and interpreted. Virtually all of these changes tend to broaden the universe of reports that may be eligible for a whistleblower award:

- **Broader definition of “voluntary” report.** Under Rule 21F-4(a), a report is voluntary if it is submitted before a government request, inquiry, or demand is directed to the individual or his representative. Thus, unlike the Proposed Rule, if a request is made to the employer and the employer interviews or obtains documents from the individual, the individual can still satisfy the “voluntary” standard under the rule. Similarly, an employee is not rendered ineligible on the basis of the “voluntary” standard if a company interviews the employee in an internal investigation where no government requests have been made. In both instances, the employee will still need to satisfy other eligibility criteria which the SEC believes will be difficult to do where the only source of original information is an existing investigation or proceeding, the information was obtained from an “excluded person” under Rule 21F-4(b)(4)(vi), or in a privileged communication (see the Issuing Release at 31, 36, 43, 83, 139, and n. 73).

- **Longer “look back” period for reports that are initially made internally.** As under the Proposed Rule, Rule 21F-4(b)(7) provides that the date of the whistleblower’s report to the Commission can be deemed to be the date of their earlier internal report. Under the Final Rule, though, the look back is 120 days (30 days longer than in the Proposed Rule). This “look back” provision ensures that individuals who elect to report internally and wait up to 120 days before going to the Commission are not penalized for making a late or delayed report to the Commission. While such an additional 30 days may not materially change a whistleblower’s incentives to report internally, the Commission made this revision to provide companies with additional time to get their arms around a matter and report it to the Commission in instances where it already has been reported internally.[11]

- **Broader standard of what type of report is deemed to “lead to an enforcement action.”** The standards for when a report meets the statutory criteria (of leading to an enforcement action) are broader under the Final Rule than under the Proposed Rule. Under Rule 21F-4(c), the following three types of reports by eligible individuals are eligible for an award in a case where monetary sanctions exceed $1 million:
  
  1. **Trigger of investigation.** The first type of eligible report is a report that is specific, credible, and timely, and triggers the opening or reopening of an investigation leading to a successful enforcement action based at least in part on the conduct identified in the report. In the Proposed Rule, the report had to have “significantly contributed” to the success of the action;

  2. **Significant contributor to ongoing investigation.** The second type of eligible report is a report provided in an ongoing investigation that “significantly contributed” to a successful enforcement action. In the Proposed Rule, the report had to be “essential” to the success of the action; or
(3) Internal report contemporaneous with, or followed by, report to the Commission. The third type of eligible report is one made through an entity’s internal whistleblower, legal, or internal compliance function, provided that the company initiates an internal investigation in whole or in part based upon that report, the company reports to the Commission, the company report satisfies either of the foregoing conditions in (1) or (2), and the individual still reports to the Commission within 120 days of the internal report. This third type of report was not covered in the Proposed Rule and would allow the Commission to determine the value of the whistleblower’s tip by looking at the overall value to the Commission of the internal investigation by the company.

Clarification of type of information that can be eligible for an award. A whistleblower is now explicitly defined in Rule 21F-2(a)(1) as someone who reports information to the Commission that “relates to a possible violation of the federal securities laws … that has occurred, is ongoing, or is about to occur.” In at least one respect, this standard may be broader than the “potential violation” standard in the Proposed Rule. By referring to a possible violation that is “about to occur,” the Final Rule explicitly allows awards for reporting even when a violation has not even happened yet.

Aggregation of sanctions in related actions to reach $1 million threshold. Under Rule 21F-4(d)(2), multiple Commission actions can be aggregated for purposes of determining whether the $1 million threshold for granting whistleblower awards has been met. This change from the Proposed Rule (which would have required $1 million in a single action) will make whistleblower awards available in more cases.

Broadening of exceptions for reporting by certain compliance, legal, and auditing personnel. The Final Rule maintains a division between persons categorically excluded from eligibility for a whistleblower award (including, but not limited to, US government officials, foreign officials, auditors engaged in an audit of an issuer’s financial statement, and persons criminally convicted for the reported conduct), and persons who are generally excluded from being eligible, with certain exceptions, because their information is not viewed as derived from “independent knowledge or analysis” (and therefore is not “original information” under the Final Rule). See Rule 21F-4(b)(4). Persons in the latter group include attorneys and others who learn information subject to the attorney-client privilege that cannot be disclosed under applicable rules. It also includes, unless an exception applies, officers and directors who are informed of misconduct or learn about it in connection with a company’s compliance system,[12] compliance and internal audit personnel, as well as employees of outside firms that are retained to perform compliance or audit work for an entity or are retained to conduct an inquiry or investigation into possible violations of the law. For this group, the exceptions in Rule 21F-4(b)(4)(v) have been clarified in the Final Rule to include the following situations:

- The individual has a “reasonable basis” to believe disclosure is “necessary to prevent … conduct likely to cause substantial injury to the financial interests or property of the entity or investors.” This exception was not included in the Proposed Rule and represents a significant expansion of the eligibility standards;
- The individual has a “reasonable basis” to believe that the entity is “engaging in conduct that will impede an investigation of the misconduct,” which the Issuing Release describes as including destroying documents or influencing witnesses. The Proposed Rule had referred to conduct that constituted “bad faith;” or

Racing to a Locked Door? SEC Issues Final Whistleblower Bounty Rule and Announces First Deferred Prosecution Agreement, Revealing Competing Incentives for Corporate Self Reporting
At least 120 days have elapsed since the information was brought to the attention of the pertinent compliance or management personnel. The Proposed Rule had simply referred to an “unreasonable delay” in corporate self-reporting.

Whistleblower’s Role in Internal Compliance Process Now Must Be Considered When Determining the Amount of an Award

Under Rule 21F-6, the Commission’s determination of where within the 10% to 30% range an award will fall remains largely unchanged, and continues to include analysis of the extent of the whistleblower’s culpability in the underlying conduct. Under the Final Rule, however, the Commission is required to take into account the whistleblower’s conduct vis-à-vis the internal compliance process by considering the following factors when determining the amount of an award. Some of these factors seem designed to encourage initial reporting to the company:

- **Factor that increases the amount of an award:** (1) “Participation in internal compliance systems,” including reporting internally in advance of or contemporaneous with a report to the Commission and assistance with the internal investigation; and (2) the timeliness of a whistleblower’s report to the Commission or the entity.
- **Factors that decrease the amount of an award:** (1) “Unreasonable reporting delay” by the whistleblower, such as failing to take steps to prevent, as well as waiting until there is an investigation; and (2) “Interference with internal compliance and reporting” by the whistleblower, such as steps to prevent or delay detection or lying to investigators.

Prohibition Against Impeding Communications with the Commission, Including Enforcing Corporate Confidentiality Agreements

As under the Proposed Rule, Rule 21F-17(a) prohibits “impeding” an individual from communicating with the Commission, including by “enforcing, or threatening to enforce, a confidentiality agreement.”[13] As under the Proposed Rule, Rule 21F-17(b) also provides that the staff is “authorized” to communicate with a whistleblower who is a director, officer, or employee of the company, without obtaining consent of company counsel.

Potential Impact of the Whistleblower Rule on Compliance Programs and the Ability of Companies to Obtain Credit for Self-Reporting

Impact on ability of companies to detect wrongdoing

- **Final Rule continues to pose an overall disincentive to internal reporting.** Whistleblowers may believe that the chance of an enforcement “action” (which the Final Rule states is “generally” defined as a “single captioned judicial or administrative action”) is higher if they bypass internal processes. The Tenaris case provides a useful example. That case arose when the customer in Central Asia reported the matter to the company (spurring the investigation and disclosure). Under the Final Rule, customers in these circumstances now may be incentivized to disclose directly to Commission. If that had occurred in Tenaris, there is real question as to whether the company would have qualified for a DPA, as its ability to discover the problem, and thus self-report, presumably would have been compromised. The most the Commission said about this issue in the Issuing Release is that it anticipates that, in appropriate cases, upon receiving a whistleblower complaint, it will contact the company and give it the opportunity to investigate the matter and report back. The company’s actions thereafter will be evaluated against the Seaboard factors.[14] See Issuing Release at 92.
Certain features of the Final Rule may preserve some level of internal reporting

- **Internal reports can increase the amount of an award.** A whistleblower's participation in internal compliance processes is now an explicit factor that the Commission must consider in determining the amount of the award (whereas before it was only mentioned in the proposing release as an optional factor to consider). This slightly strengthens the potential for an increased award amount based on internal reporting.

- **Internal reports can increase the chance of eligibility.** Because individuals can recover a bounty based on an internal report that the company develops and reports to the Commission, this may incentivize some individuals to file internal reports. In so doing, provided that they report the information to the Commission within 120 days, they may be able to get credit (a) based upon an internal report that would not, by itself, have qualified for an award or (b) for the entire penalty for a larger problem that they did not even know about.

**Impact on corporate internal investigations of, and response to, wrongdoing**

- **Potential increased leverage to secure cooperation of certain employees in internal investigations.** As noted above, when determining the amount of an award to an individual, the Commission must consider the extent to which the individual interfered with internal compliance processes. This creates at least some increased incentive to cooperate with internal investigations, insofar as a witness intends to file a whistleblower report and is interested in maximizing the amount of the potential award.

- **Non-waivable whistleblower protections may be enforced by the Commission, and potentially could cover employees who make internal reports without filing a report with the Commission.** The Act (§ 922 codifying Exchg. Act § 21F(h)) afforded individuals who report information to the Commission, including employees of foreign affiliates of an issuer, increased protection against retaliation by the employer, including a right to file a civil action. In the view of the Commission, these protections cannot be waived. *See* Issuing Release at 19-20. The Commission also states that it has authority to enforce these protections (thus there is a now an additional potential basis for company exposure to the Commission). *Id.* at 18. In addition, Rule 21F-2(b) clarifies that the protections are triggered by the whistleblower’s report, even if the report does not lead to an enforcement action.[15]

**Impact on corporate self-reporting**

As noted above, the Final Rule creates incentives for self-reporting that push companies in competing directions—on the one hand, to report earlier and even prematurely; while, on the other hand, potentially disincentivizing them to self-report at all. These competing dynamics arise for the following reasons:
Incentive for early, even premature, corporate disclosures remains. Although the Final Rule extended the tolling period for a whistleblower to go to the Commission after making a voluntary internal report from 90 days to 120 days, it is unlikely this extension will meaningfully afford a company sufficient time to adequately and appropriately gather evidence and make reasoned judgments about complex factual and legal issues, especially in the FCPA area. Also, by suggesting greater “leniency” will be given to companies that promptly self-report following receipt of an internal whistleblower report, and by indicating such companies may be allowed to perform their own investigations before the staff decides its own investigative course, it is clear the Commission is trying to create incentives for companies to self-report soon after they receive an internal report. In addition, certain control/compliance personnel, as noted above, also remain able to become eligible to file a report (after 120 days, or even before, such as when the individual reasonably believes there will be a “substantial injury to investors,” or that the investigation will be impeded). These dynamics, as well as others, place further pressure on corporations to prematurely self-report.

Disincentive to self-reporting created by potential for reduced cooperation credit when a whistleblower beat the company to the door. The Commission may not view a corporate self-report as being early enough, voluntary, or complete under the Seaboard factors if the Commission already has received a confidential whistleblower report of which the company is not aware. This could affect a company’s eligibility for more favorable resolutions (no charges, NPA, DPA), lesser charges (accounting violations or a charge not based on Section 10(b) of the Exchange Act), or lesser penalties.[16] Thus, without further clarification, some companies may decide to err against self-reporting, particularly where a problem is discovered that has been going on for some time and there is a meaningful possibility that the problem already has been the subject of a whistleblower report to the Commission.

Tension between NPA/DPA outcomes and whistleblower award eligibility

For a whistleblower to obtain an award there must be an enforcement “action.” The rule defines an “action” “generally” as a “single captioned judicial or administrative action.” Neither a NPA nor a DPA would appear to meet this definition and the Issuing Release does not address the issue. Plainly stated, in order to maintain existing incentives for cooperation, the Commission will need to ensure that corporations are not charged in civil injunctive actions or administrative cease-and-desist proceedings (and therefore denied a NPA or DPA outcome they would otherwise deserve) in order to preserve a whistleblower’s eligibility for an award.

Need for clarification of how Seaboard factors will be applied in whistleblower cases

The Seaboard factors were devised at a time when strong whistleblower incentives did not exist. Over the years, self-reporting achieved heightened prominence and essentially became a requirement for a company to avoid an enforcement action or achieve a no-penalty outcome. The whistleblower rules predictably may reduce internal reports, nullifying the ability of companies to truly self-report. To account for this reality, the Commission either should rebalance the Seaboard criteria, or else make clear that regardless of the whether a whistleblower makes an internal report or goes directly to the SEC, a company can still avoid an enforcement action. The Commission also should expressly state that where the whistleblower has gone directly to the SEC, a company can still obtain a reduced penalty or no-sanction outcome.
The Commission could state that when a whistleblower reports only to the Commission, it will only consider the company’s remediation and cooperation efforts in deciding whether to afford the company an outcome without charges or a penalty. Such an approach would acknowledge that the ability of a company to make a prompt self-report is limited by the approach taken by the whistleblower.

To continue to incentivize companies to maintain strong internal monitoring procedures, the Commission could announce that a company’s self-policing efforts will be credited even if they are not used in the particular case. This might mean that the Commission would examine a company’s compliance staff and the procedures they normally follow when they receive information about a securities violation.

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Special thanks to J. Shaw Vanze for assistance with research used in this advisory.

[1] That is, before the occurrence of any internal report by the whistleblower or notice to the company by the Commission.

[2] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969 (Oct. 23, 2001) (listing the following among four factors used to evaluate the degree of credit to afford a company: “Did the company promptly, completely, and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? … Did the company voluntarily disclose information SEC staff did not directly request and otherwise might not have uncovered?”).


[4] For example, in bringing enforcement actions against two senior executives of Apple, Inc., the Commission noted exemplary cooperation by the company, including prompt self-reporting, and publicly announced that it was declining to take enforcement action against the company. SEC Press Rel. No. 2007-70 (Apr. 24, 2007). See also, e.g., SEC Press. Rel. No. 2006-02 (Jan. 3, 2006) (announcing similar action against executives of Putnam Fiduciary Trust Co. while declining to take action against company based in part on company self-reporting). By contrast, rarely, if ever, has the SEC declined to take enforcement action against a company that did not self-report (though other Seaboard factors still may reduce penalties, affect charges, or influence the form of disposition of the matter or forum in which the matter is brought).

[5] Although the Issuing Release makes several references to self-reporting and cooperation, and suggests there are circumstances where a company may be able to claim and receive credit for both (see Issuing Release at 34, 55, 76, 77, 90, 92), the Commission’s clearest statement on the matter concerns the circumstances where a whistleblower has initially made an internal report to the company and the company then reports to the SEC (Issuing Release at 76). In that circumstance, the Issuing Release (at 232 n. 455) and Rule 21F-6(a)(3)(ii) suggest the benefits, if any, to the company may be in
the form of reduced or eliminated monetary sanctions. A far less definite statement indicates that where a whistleblower first goes to the Commission and the staff chooses to contact the company “good cooperation by the company overall, even in response to contact from the Commission staff, might mean the monetary sanctions will not be any greater than if a whistleblower had simultaneously reported internally” (Issuing Release at 232 n. 455).

[6] The SEC Enforcement Manual (updated Feb. 8, 2011) provides further detail on the characteristics of DPAs, NPAs, and the circumstances in which they may be used.

[7] With regard to the $3.5 million criminal penalty under the DoJ NPA, the DoJ has stated the penalty was “substantially reduced” due to “extraordinary cooperation” which included disclosure that was “timely and complete.” See DoJ Press Rel. (May 17, 2011).

[8] Based upon our reading of the SEC Enforcement Manual, it is not clear that this outcome is required in Commission DPAs. According to the Manual, in DPAs, “under certain circumstances” (e.g., prior history of violations by the company), the company will be asked to agree either to “admit or not to contest underlying facts that the Commission could assert to establish a violation.” SEC Enf. Man. at 130-31 (emphasis added). Tenaris agreed “not to contest” the allegations publicly, or in any enforcement action the Commission could file based upon breach of the DPA. See DPA ¶ 15. The Commission may be increasingly pressuring companies to make some explicit recognition of wrongdoing, at least in high-profile cases. See SEC v. Goldman, Sachs & Co. and Fabrice Tourre, Case No. 10-cv-3229 (S.D.N.Y.) (Consent of Goldman, Sachs & Co. of July 14, 2010, at ¶¶ 2-3) (while disclaiming any admission or denial of allegations of the Commission, admitting that certain conduct was a “mistake”).


[10] With respect to conduct occurring before the passage of Dodd-Frank, the Issuing Release states that Rule 21F-4(b)(1) does not “categorically exclude through the definition of ‘original information’ tips about violations that may arguably be beyond an applicable statute of limitation or that a company may have addressed through remedial action.”

[11] However, the Commission in the Issuing Release cautioned companies not to interpret the 120-day period as a “grace period” for determining their response to violations and stated that the “promptness with which entities voluntarily self-report their misconduct” “is an important factor” in considering “whether and to what extent to grant leniency” to entities who are cooperating in Commission investigations. See Issuing Release at 76. The Commission also stated that a company may self-report before its investigation is completed and in those instances the staff may decide to stand down and await further results of the internal investigation before deciding its own investigative course. Id. at p 77.

[12] Officers and directors, however, are eligible on the basis of the “independent knowledge or analysis” standard if they personally observe possible violations at the company.

[13] The Final Rule also narrowed the “voluntary” requirement to exclude individuals who have a direct pre-existing legal or contractual duty to report information to the Commission, as opposed to a duty imposed by a third party. By narrowing the exclusion, the Commission was responding to concerns that
employers might attempt to preclude their employees from whistleblower eligibility by generally requiring all employees to report evidence of securities violations directly to the Commission.

[14] According to the Commission, in determining whether to offer the company this opportunity the staff may consider, among other things, information it has concerning “the nature of the alleged conduct, the level at which the conduct allegedly occurred, . . . the company’s existing culture related to corporate governance . . . [and] the company’s internal compliance programs, including what role, if any, internal compliance had in bringing the information to management’s or the Commission’s attention.” See Issuing Release at 92 n. 197.

[15] Indeed, courts already may are facing the question of whether the anti-retaliation provisions are triggered at an earlier stage—when the individual reports information internally. See Egan v. TradingScreen, Inc. et. al, Case No. 10-cv-8202 (S.D.N.Y) (Opinion and Order of May 4, 2011) (declining to dismiss retaliation suit predicated on internal report by an individual who allegedly expected the company would disclose the information to the SEC).

[16] Although Rule 21F-6(a)(3)(ii) indicates that a company’s monetary sanction may be reduced or eliminated when an entity self-reports following a whistleblower’s related internal report, the Commission does not adequately (if at all) explain whether any benefits would exist where an entity self-reports following an undisclosed whistleblower report to the Commission. At best, the benefits in either type of report (to the company or to the SEC) appear to be limited to monetary considerations.