ROUNDTABLE

White-Collar Defense

EXECUTIVE SUMMARY

Federal regulators and prosecutors, as well as international authorities, continue to emphasize the enforcement of the Foreign Corrupt Practices Act (FCPA). In the first few months of 2010, the U.S. government collected $1.2 billion in fines and settlements related to FCPA violations, and there are currently about 140 open U.S. Department of Justice (DOJ) investigations in this area. Practitioners report seeing FCPA enforcement trends involving the increased prosecution of individuals, wider coordination among international prosecutors, the expansion of enforcement into new industries, and the use of innovative investigative strategies. Additionally, proposed U.S. legislation could increase FCPA risk by incentivizing whistleblowers and creating severe penalties for government contractors.

Our panel of experts discusses these topics, as well as issues related to strategic remedies for financial fraud victims, the importance of robust compliance programs, and notable cases to watch. They are Mary Carter Andrues and Terree Bowers of Arent Fox; Michael Farhang and Debra Wong Yang of Gibson, Dunn & Crutcher; Jan Handzlik of Greenberg Traurig; and Mark Mermelstein of Orrick, Herrington & Sutcliffe. The roundtable was moderated by *California Lawyer* and reported by Laurie Schmidt of Barkley Court Reporters.

MODERATOR: What developments are you seeing with regard to the FCPA?

WONG YANG: Much has happened in the last couple of years as enforcement in this area has exponentially increased. This year, the most notable change has been the global coordination among prosecutorial offices around the world. You are starting to see the effects of the global economy on fraud investigations. The expansiveness of investigations, the increase in penalties, and the costs to corporations, stem from this international enforcement, which applies both to coordinated investigations and to individual country investigations.

HANDZLIK: One change we have seen domestically is the increased prosecution of individuals. DOJ has made a point of investigating and prosecuting officers and employees of companies, and they are seeking severe prison sentences.

MERMELSTEIN: There have been several high-profile FCPA trial losses for the defense: Frederic Bourke, former Rep. William Jefferson, and Gerald and Patricia Green. Jefferson received a sentence of 13 years for an FCPA-related matter, which is unprecedented. These are serious losses that are being punished with real prison terms.

BOWERS: There is not only a greater dedication of resources toward investigations, but also a willingness to use more innovative investigative tactics—even techniques used in terrorism cases are now being applied to white-collar cases with undercover operations where wires have been worn. Investigations are also going into industries that were not previously the focus of investigations, such as the entertainment industry.

ANDRUES: Also on the horizon are the proposed whistleblower provisions in the Financial Regulations Bill before Congress. The bill will create a greater incentive for the public to play a whistleblower role in FCPA cases because there will be a pot of money to collect—between 10 to 30 percent of the fines collected by authorities, depending on how the House and Senate bills are reconciled.

FARHANG: Governments appear to be shoring up their resources and their statutes to strengthen the authority of various agencies to go after this type of conduct. In the United Kingdom (UK), you have the new UK Anti-Bribery Act, which is in some ways stricter than the FCPA, and the UK is creating a fraud super-agency to replace the Serious Fraud Office (SFO), the Financial Services Authority, and another regulatory body. There is also the recently proposed legislation in the U.S. to debar contractors who are found to have violated the FCPA.

WONG YANG: The government is also expanding the types of statutes that prosecutors use to charge crimes. Aside from the traditional FCPA violations, they're using money laundering and the Travel Act (18 U.S.C. § 1952). The latter is particularly notable because you can charge individuals for bribing private persons, which is quite different from the traditional scenario of bribery related only to a government official.

HANDZLIK: Commercial bribery has become an important issue, not only in the U.S., but in such places as the UK, where possible criminal penalties have been enhanced, and the People's Republic of China, where a criminal commercial bribery statute was recently enacted. When the authorities can go after a private individual in a commercial setting for supposed payoffs, the possibilities for regulators and prosecutors are greatly increased.

ANDRUES: The government has also been drawing on trial techniques typically used in other types of crimes. In *U.S. v. Bourke,* the government relied on the willful blindness or deliberate ignorance jury instruction, which is generally used in drug cases.

WONG YANG: With FCPA investigations exploding in the last five years, the government is naturally grappling with how to handle the volume. DOJ has been putting additional prosecutors on these cases and working closely with the U.S. Securities and Exchange Commission (SEC). The SEC has expanded into regional offices with attorneys focused specifically on FCPA. But you are also seeing new ways to address the growing volume; there were two matters in 2009 where the government allowed two companies, UTStarcom and Helmerich & Payne, to engage in self-monitoring as part of their non-prosecution agreements, rather than impose a third-party monitor.

HANDZLIK: U.S. enforcement officials have increased their efforts to apply our laws internationally. At the

same time, the number of open investigations and prosecutions has dramatically increased over the past year. Part of the reason for this is that DOJ and SEC lawyers have been able to increase the number of cases they handle—they use lawyers for private companies to do the investigations for them. And since they're going after individuals with greater vehemence, I predict they will develop more cooperating witnesses than in the past.

FARHANG: There is also a growing tendency for companies to identify FCPA problems through other types of investigations. For example, companies may be looking into possible internal misconduct overseas and uncover FCPA issues that they didn't realize existed. Or, there may be an investigation into other business or trade issues that may yield questions about the relationships that the overseas entities have with third parties, creating a new set of questions related to the FCPA. You see companies doing merger due diligence that can then turn into internal investigations. FCPA questions can arise in a variety of circumstances.

ANDRUES: One issue that companies are grappling with is whether there really is a facilitation payments exception to the FCPA anymore. It's very difficult to fit a factual scenario squarely within the exception, and to the extent there is one, many companies are concerned about relying on it unless they can obtain an advisory opinion ahead of time because it is not well defined.

WONG YANG: There has been ongoing retrenchment in the facilitation payments category. For example, in the past, there was an exception for media payments, and now, even that's in question. It is tricky to advise corporations when the definition of a facilitation payment is changing.

BOWERS: It's also difficult if you're dealing with a country or a culture where it's the standard, and it becomes a cost-benefit analysis. But even with today's aggressive approach by regulators and prosecutors, there are payments that can be made legally and appropriately. It's just riskier, which creates even greater need for consultation and advisory opinions before payments are made.

MERMELSTEIN: Under the new UK statute, there is no "facilitating payments" exception. So even if it fits under American rules, it's not a practical defense if you're dealing with a multi-jurisdictional problem.

More generally, given the increase in FCPA activity, has there been an actual shift in the corporate mindset? Do companies realize that there are some things they shouldn't be doing, or are decisions still made primarily by considering risks verses rewards?

HANDZLIK: In my experience, it's somewhere in between. Of course, responsible companies will continue to act in an ethical and lawful manner. And all companies are seeing the costs of due diligence and law compliance increase. Most everyone recognizes the threat of prosecution as a fact of life. The basic problem is knowing right from wrong, especially when the competition is engaged in similar activity. Prosecutors say they know a bribe when they see it, but of course, that's after the fact. Companies must make real-time decisions, and the answers are not always clear-cut. Under significant economic pressure, some companies may look for a more acceptable way to describe payments, rather than walking away.

Debra [Wong Yang] and I both served as FCPA law compliance monitors. In that position, we observed significant changes, not necessarily because companies are becoming more moral, but because people are more aware of the possible pitfalls and are taking steps to avoid them. In large measure, that's why the use of compliance programs and audits have increased in recent years.

WONG YANG: If a company plans ahead, it does have a great amount of control over a situation, even in a less transparent country. However, many businesses are expanding by acquiring foreign companies. In that scenario, the parent company is potentially inheriting a situation that's deeply entrenched, and it may not be easy to rectify, even with the best policies and procedures.

FARHANG: There can also be liability related to the conduct of third parties that a company deals with. There is even potential liability in the case of joint ventures, where the company is not even a majority owner, but where it hasn't made reasonable efforts to encourage the venture to comply with the FCPA. Companies would do well to look at statements made by top DOJ officials about their focus on FCPA enforcement.

ANDRUES: It is one thing for the government to increase enforcement efforts, but it then also has an obligation to increase its advisory role regarding what it believes is lawful activity. Very few advisory opinions are issued. It may be that businesses are not taking advantage of the process because they have to lay out details about potentially controversial activity. It is also a lengthy process, and clients often cannot wait for the DOJ to issue an opinion because they must make timely decisions.

HANDZLIK: In the case of export controls and certain foreign investments, due diligence, self-reporting and, in some cases, licenses are required. Why can't DOJ establish an effective, voluntary clearance process for FCPA matters, so companies wouldn't be reluctant to come forward in close cases? I'm not advocating mandatory reporting and review, just improvements in DOJ's voluntary clearance process.

WONG YANG: If you do an analysis of the voluntary disclosures in this area, you don't necessarily see a bright-line benefit between disclosing and not disclosing. If there were a clearer sense as to how the voluntary disclosure would benefit a company, it would be a much easier decision for executives, audit committees and boards.

MERMELSTEIN: Compare the FCPA with the antitrust side of things, where if you're the first one in, you get complete immunity. There is no comparable tangible benefit on the FCPA side. Ultimately there is a benefit—for example, a deferred prosecution agreement (DPA) or a non-prosecution agreement—but it's not explicit enough for business executives to rely on.

The most notable change has been the global coordination among prosecutorial offices around the world. ***—Debra Wong Yang***

BOWERS: If there were a developed history where companies were getting the green light for certain conduct, then you'd see a change in corporate behavior. But instead, you get ambiguity or a directive to not do something. If you want to encourage companies to take advantage of an advisory process, you have to occasionally let them do what they're asking to do.

FARHANG: Given the volume of investigations, the DOJ needs to come up with better incentives for companies to self-disclose. If they don't have a certain level of predictability, it will be much harder for companies to assess what makes sense as a next step if they discover an issue internally.

MODERATOR: What are some of the issues related to strategic remedies for victims related to Ponzi schemes and other financial frauds?

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ANDRUES: If the target company is essentially bankrupt, then Ponzi receivership victims are going to have to get in line with the other lien holders. But if they can bring a class action against a third party, such as an accounting firm for not properly auditing, they may be able to find an alternative remedy by looking for a different pocket.

MERMELSTEIN: In *U.S. v. Madoff,* some of the feeder funds are being sued, and there will likely be more of those suits. There may yet be criminal action against some of those feeder funds, as well, because of the sheer amount of money they were able to make from those transactions.

If you're dealing with a Ponzi scheme of any magnitude, a defendant is looking at a Federal Sentencing Guidelines range in excess of ten years, even if he or she offers meaningful cooperation. I have found that if you cooperate on the civil side with a receiver, you can have some success in keeping someone out of custody for the duration of the cooperation. But once you get to the criminal plea and sentencing, you're still looking at a huge sentence, even with meaningful cooperation.

HANDZLIK: Class actions are a uniquely American remedy for victims to pool their resources and try to get their money back. It hasn't caught on in other parts of the world. Slowly but surely, we're seeing something like a class action remedy developing in Europe. In particular, The Netherlands has enacted a law allowing the settlement of mass claims, mostly without regard to nationality.

WONG YANG: I've noticed situations where the SEC receivers have become more expansive in terms of who they're willing to try to recover monies from. The courts are sensitive to the public hue and cry, and seem comfortable letting them go after various professional entities.

BOWERS: You're also seeing a much more aggressive use of the clawback. If you were an early investor and you got your money back through the Ponzi scheme, trustees and regulators are recapturing those funds and putting them into the overall pool to be shared with all victims. It's part of an expansion of the role of victims, both in civil and criminal prosecutions internationally.

Domestically, we have a Victims' Rights Bill, which gives victims notification rights, and sometimes they get restitution. But by the time somebody is indicted or charged, usually the funds are gone and the chances of meaningful restitution are slim, which is why victims take advantage of collateral parallel proceedings involving civil remedies against third-party participants.

FARHANG: SEC and DOJ investigations are a big hammer

to use against defendants, but oftentimes, investors are left with few a cents on the dollar—if there even is a recovery. Private litigants are going to be much more common over time as Ponzi schemes get bigger as seen in the *U.S. v. Stanford* and *Madoff* cases. But the targets in those private litigations are going to be a much broader group than what prosecutors would encompass in their cases.

BOWERS: It presents an interesting choice for prosecutors with regard to parallel civil proceedings because the traditional view is to stay parallel civil proceedings due to concerns about compromising the evidence or disrupting the investigation. But in reality, justice delayed may be justice denied.

HANDZLIK: There has also been an increasing use of freezing orders and efforts to seize and forfeit suspected ill-gotten gains. This has the possible benefit of protecting the victims. But, of course, when the investigation drags on for years, it prevents the subjects of the investigation from using those funds for legitimate purposes. In the UK, as a result of the new anti-bribery law, coupled with procedures already on the books, even if $1 out of $1 billion is tainted, all of the funds are frozen until the company or the individual comes forward to prove the funds aren't derived from illicit sources. We're going to see much more of that.

MERMELSTEIN: What Jan [Handzlik] raises is the fact that the government has certain advantages in pursuing these kinds of cases. So it can make sense to refer cases to the government, rather than pursuing civil litigation. If we have confidence that the government will seize assets and move on an investigation, then the concept of a criminal referral to the government, which lets them do the prosecution as opposed to initiating a civil lawsuit, makes a lot more sense.

WONG YANG: Victims are also going into different prosecutorial offices in a relevant state, county or city that has a strong fraud group to get multiple investigations going. That's one way for a victim to try to get a quicker resolution and more immediate attention.

BOWERS: These cases also depend on the individual prosecutor, and that's why it's important to develop relationships with experienced prosecutors. The government obviously has access to resources that private litigants don't.

Elected prosecutors also have learned that the Section 17200 case is a statute that can capture any fraud, and we've seen expanded use of it. It's important for companies to understand if it is facing a 17200 case, you need a white-collar defense attorney to handle it (See Cal. Bus. & Prof. Code § 17200).

MODERATOR: What are the potential impacts of the revisions to U.S. Sentencing Guidelines for Compliance Programs?

BOWERS: It's clear with the amendments to the Sentencing Guidelines and recent pronouncements from the DOJ that companies must have robust compliance programs. The main objective of a good compliance program is to make sure that you're identifying problem areas, and if you do make a mistake, that you have a process for self-reporting. There are benefits for self-reporting: You may not be charged and you can gain non-prosecution agreements. The DOJ has indicated that a strong compliance program may even keep you from having an external monitor, which is an expensive proposition.

FARHANG: Compliance programs are a tool that helps companies avoid prosecution and substantial penalties down the road if issues come up. One byproduct is that over time, there will be a homogenization of what an effective compliance program is considered to be. Eventually, there will be greater attention to benchmarking compliance programs, which we're already beginning to see. Companies are observing what their competitors are doing. They are asking, "Does the compliance officer report to the general counsel? Is the compliance officer a lawyer or not?" All of these questions are now going to be the subject of great attention by companies who want to make sure that their compliance program meets the criteria of what the DOJ and the courts consider to be effective.

MERMELSTEIN: A compliance program is probably the single best form of insurance that an executive can purchase. Because if there are allegations against an executive related to the wrongdoing of an employee 5,000 miles away, the question will be, "What did the executive do to try to prevent it?" If a reasonable amount of money can be spent on the front-end to create a detection program, then at least that executive can say that he or she did whatever they could to prevent it. When an effective compliance program isn't in place, executives do face severe penalties.

WONG YANG: The amendments to the Sentencing Guidelines are a reflection of trends I've seen in the health care industry. The regulatory bodies have put a growing emphasis on the compliance functions and those responsible for compliance. Increasingly, you can see their desire for the compliance chief to have a direct pipeline into the board of directors. You look at some of the DPAs and Corporate Integrity Agreements (CIAs) in the health care arena and you will see this area singled out. Notably in

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the Bayer settlement, the regulatory authorities created a tribunal of compliance consisting of health care compliance experts who reported directly to the board of directors. Eli Lilly and Pfizer's CIAs and settlement documents also include a similar requirement. Regulators are frustrated by the recidivism they've seen, and this is starting to manifest in the demand that the compliance function and compliance officer have a prominent role. This can pose significant issues for in-house counsel.

HANDZLIK: The Sentencing Guidelines are certainly important, but they come into play at the end of the process. The initial objective is obviously to avoid indictment or an SEC civil fraud suit. In January of this year, the SEC released a revised Enforcement Division Manual discussing the factors it will consider in enforcement investigations. This updated the so-called Seaboard Memorandum of 2001, which emphasized cooperation with the SEC staff and compliance programs as a way to avoid an enforcement action. As we know, DOJ has similar guidelines emphasizing the importance of effective compliance programs and meaningful cooperation to avoid prosecution. For the SEC and DOJ, an effective compliance program is a basic requirement for companies of any significant size.

ANDRUES: A distinction has to be made between compliance programs that are merely on paper and those that are functional. Procedures for prevention, detection, and remediation, must be coupled with procedures for auditing the efficacy of the program.

FARHANG: This is a big area for government contractors because the Federal Acquisition Regulations now require companies to self-report federal criminal violations, and part of the requirement is that they have an effective compliance program.

ANDRUES: Compliance programs are really essential in the government contracting area when you are faced with parallel proceedings in the criminal division and on the civil side with the False Claims Act (FCA) (31 U.S.C. § 3729-3733). With a good compliance program, you can fend off the criminal investigation, and then use the program as a shield and a sword in the FCA arena. If the company has mechanisms in place—a hotline for reporting misconduct is an important one—and the whistleblower does not take advantage of them, a buoyant compliance program can be used to reduce FCA exposure.

WONG YANG: A compliance policy is really a starting point. Prosecutors are trained to understand that every company has its own personality, and to do a deep-dive to find out how it's used, how it's trained, whether or not people really understand it. Unless you're a small business that hasn't been around for very long, there is an expectation that you have a solid program.

BOWERS: It's not just about the compliance program; it's about the corporate culture. If the importance of the program is not communicated from the top, it will not be successful.

MERMELSTEIN: One thing that can be done is a compliance audit, which involves going into a company, looking at the program and testing it out. We'll see if individuals on the ground actually know anything about the compliance program; we'll look at a smattering of e-mails, or focus on a particular office location to see what the company is actually doing. It's a check-up, if you will, of a compliance program.

ANDRUES: Oftentimes you hear the term "compliance program" as though it's a single document; but if you have, for example, a publicly traded company that exports military items under a U.S. government contract and the company uses a cost-accounting system, you need to have a top-down analysis of the business operations to create appropriate programs for each division of the company.

MERMELSTEIN: We've talked a lot about government contractors. It should also be noted that the British Anti-Bribery Act covers private citizens as well—it's any bribery, whether to a government contractor or not. So everything that we have discussed is going to apply to any country with a British nexus, regardless of whether a foreign government official is involved.

MODERATOR: **What are the notable cases that you are watching?**

WONG YANG: The SEC action involving Maynard Jenkins, the CEO of CSK Auto Corporation, is one to watch. It's the SEC's first attempt to seek reimbursement from an executive under Sarbanes-Oxley's clawback provision who hasn't been otherwise found guilty of any wrongdoing. The case presents a big change in terms of how the SEC is pursuing alleged ill-gotten gains.

ANDRUES: There are three cases in front of the U.S. Supreme Court (*Weyhrauch v. U.S.*, *Black v. U.S.*, and *Skilling v. U.S.*) all challenging the vagueness of the Honest Services statute (18 U.S.C. § 1346), which has been used, and recently somewhat abused by the government. The statute primarily was used against politicians who had engaged in a scheme or artifice to deprive another of the intangible right of honest services. It's been broadened to apply to businesspeople. I do think it's a vague statute. I liked it as a prosecutor; I find it troublesome as a defense attorney. If the Supreme Court determines that it is unconstitutionally vague, prosecutors are going to have to rethink how they charge these cases.

MERMELSTEIN: The sentencing of Hollywood movie producers Gerald and Patricia Green, who both went to trial on a FCPA violation, is going to be interesting. They were accused of conspiring to pay $1.8 million in bribes to the Tourism Authority of Thailand to acquire the rights to produce the Bangkok Film Festival. They lost at trial, and prosecutors are seeking upwards of 20 years for the senior principal, who is in his 70s. That would effectively be a life sentence.

HANDZLIK: In light of recent court decisions, defending against federal fraud cases has become more challenging. Conspiracy prosecutions are still a favorite of prosecutors, just as they were when I was a federal prosecutor. But the increasing use of willful blindness to the consequences of your acts is deeply troubling. The government is allowed to argue that the defendant had a criminal intent, because he or she intentionally looked away from supposedly questionable conduct. But in the context of a complicated business fraud case, intent is in the eye of the beholder.

FARHANG: Another case to watch is the SEC action against the former CEO and a top manager at Countrywide Financial, which stems from the collapse of the mortgage-backed securities market. The case goes to trial this year, and it will be interesting to see how the SEC's theory of securities fraud plays out following the collapse of that market.

ANDRUES: One of the things I have noticed is the increasing tendency by Congress to add whistleblower provisions to statutes, seemingly as a revenue generator. It used to be that whistleblower provisions were confined to the FCA; now there seems to be a proliferation of whistleblower provisions, including the proposal for the FCPA to include one.

BOWERS: A corollary is how a variety of inspectors general and so-called czars are now looking at the use of federal funds that have been injected into the economy by evaluating corporate behavior for possible criminal malfeasance, but also by evaluating whether corporate conduct passes a sound business judgment test. This is a much deeper infiltration into businesses by government regulators than in the past, and it could end up creating a new set of standards that corporations will have to address. ■