

FCPA VOLUNTARY DISCLOSURES: A RISK/BENEFIT ANALYSIS

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" ... [A]lthough nothing is off the table when you voluntarily disclose, I can tell you in unequivocal terms that you will get a real benefit ... "

Despite these heartening words uttered in 2006 by the then Assistant U.S. Attorney General Alice S. Fisher, an attorney representing a corporation cannot recommend voluntary disclosure of potentially criminal FCPA activities without weighing the promise of a "real benefit" against the very real risks.

THE FCPA

The Foreign Corrupt Practices Act ("FCPA"), 15 U.S.C. §§ 78m, 78dd *et seq.*, makes it a crime to make or offer a corrupt payment to a foreign official for the purpose of obtaining or retaining business. Penalties range from five years' imprisonment to a \$2 million fine for a corporation. The FCPA also requires an issuer to keep accurate books and records and maintain a system of internal accounting controls sufficient to permit preparation of financial statements in accordance with GAAP. A violation of the accounting provisions can result in civil penalties, whereas a "knowing" circumvention can expose a company to \$25 million in criminal penalties and result in imprisonment for up to 20 years for individuals.

By definition, FCPA crimes generally occur thousands of miles outside of the United States. Why would counsel advise a corporate client to bring such activities to the attention of the SEC or the DOJ? Is it necessary to self-report when, as a good corporate citizen, the client has investigated thoroughly, corrected the problem, and taken substantive remedial measures including firing the wrongdoers and correcting the financials? There is no easy answer, but a review of the past five years in FCPA prosecutions and voluntary disclosures is instructive.

SOX AND THE INTERNET

In the recent past, the Department of Justice (DOJ) has benefited from a significant increase in FCPA voluntary disclosures. Sixty four percent of FCPA enforcement actions in 2006-2007 were voluntary disclosures. See "FCPA - 2007 Enforcement Trends" *Covington E-Alert* (5/9/2008). See also Remarks of Christopher A. Wray, Assistant Attorney General, Criminal Division, to the ABA White Collar Crime Luncheon (Feb. 25, 2005), available at http://www.usdoj.gov/criminal/press_room/speeches. Mark Mendelsohn, Deputy Chief of the DOJ's Fraud Section, reported 11 voluntary disclosures in March 2006 alone. See Marie Leone, *Coming Clean About Bribery*, CFO.com (April 3, 2006).

This increase can be attributed to several factors, including the enactment of the Sarbanes-Oxley Act of 2002 (SOX). SOX requires CEOs and CFOs to certify both that the company's financials are truthful and accurate and that they are personally responsible for the company's internal controls. They are also obligated to report to the auditors and Board of Directors any significant deficiencies in the design or operation of internal controls. A willful failure to comply with these responsibilities can result in personal criminal exposure of up to 20 years' imprisonment. Layered over these obligations are the SOX whistleblower provisions. Section 806 of SOX provides recourse to employees who are retaliated against when they disclose to management information that they reasonably believe to be a violation of federal securities law, the rules of the SEC, or any federal law relating to fraud against shareholders. Such an employee could be entitled to compensatory and special damages, reinstatement, back pay with interest, damages for pain and suffering, litigation costs, reasonable attorneys' fees, and expert witness fees. As of April 2006, there had been roughly 750 SOX whistleblower suits. Kathleen Day, "Whistle-Stop Campaigns," (April 23, 2006) at www.washingtonpost.com. These suits can lead to shareholder suits and full-blown SEC and DOJ investigations.

The risk that wrongful conduct overseas will be prosecuted in the US is also heightened by a recent trend of increased enforcement of long-ignored bribery laws abroad, which brings with it increased media interest. See, e.g., Cristina Zagaria, "Ricette anche ai morti: Maxi-truffa ai danni delle Asl", *La Repubblica*, July 8, 2003, (Italian public corruption cases) ; Barboza, "Ripples Keep Spreading in a Chinese Bribery Case" (December 1, 2006) at NewYorkTimes.com. Given our increasingly interconnected global media, US prosecutors can be informed of FCPA violations miles away in real time with little or no investment of their own resources. This risk will only increase once the pending agreement between the United States and Europe easing data privacy restrictions on the transfer of information from Europe to US enforcement agencies is signed. See Charlie Savage, "U.S. and Europe Near Agreement on Private Data," *The New York Times*, June 28, 2008.

The DOJ's "Principles of Federal Prosecution of Business Organizations," commonly known over the years as the "Holder," "Thompson," "McNulty" and now "Filip Memorandum" and initially published in 2003 on the heels of SOX, also played a significant role in the surge of voluntary disclosures. The Thompson Memorandum placed an "increased emphasis" on a company's cooperation with the government when considering whether to prosecute. "Voluntary disclosures" were an important part of that cooperation. Although the "Memorandum" has gone through several iterations, the cooperation and disclosure aspects continue to be important factors considered by the DOJ.

HAVE VOLUNTARY DISCLOSURES RESULTED IN A 'REAL BENEFIT'?

Although non-prosecution agreements ("NPAs") are often the holy grail in voluntary disclosures, they do not come without risks. See *Stolt-Nielsen, S.A. v. United States*, 442 F.3d 177, 180 (3rd Cir. 2006). In 2003, Stolt-Nielsen voluntarily disclosed its involvement in a criminal antitrust conspiracy under the Antitrust Division's Amnesty Program in exchange for the government's promise not to prosecute. One year after admitting Stolt-Nielsen into the program, the Antitrust Division threatened to indict the company, claiming that Stolt-Nielsen had misstated the period of its involvement in the conspiracy. Stolt-Nielsen moved for an injunction. After a two-day hearing, the district court found that Stolt-Nielsen complied with the NPA and enjoined the DOJ from indicting. But the Third Circuit reversed, holding that a decision not to indict was solely within the ambit of the DOJ even though the court agreed with the district judge that the indictment may have been improper. On Sept. 6, 2006, Stolt-Nielsen was indicted, and on October 30, 2006, the Supreme Court refused to grant Stolt-Nielsen *certiorari*. *Stolt-Nielsen, S.A., et al., Petitioners v. United States*, 127 S. Ct. 494 (2006).

Even if an NPA is honored by the DOJ, a company may still have issues. Today's NPAs usually come with a requirement that the company install and pay an "independent consultant" who is tasked with reviewing the company's internal controls and issuing a report to the SEC and the DOJ. *See, e.g., In re Schering-Plough Corp.*, SEC Rel. No. 34-49838 (Cease-and-Desist Order, June 9, 2004). Should the monitor discover conduct that was not previously disclosed, the NPA will not prevent a criminal referral. Also, NPAs are made public in DOJ press releases with companies often accepting responsibility for the actions disclosed. Once the matter is public, shareholder suits are likely to result. *See, e.g., In re Titan Inc. Securities Litigation*, No. 04-0676 (U.S. Dist. Ct. S.D. Cal., Sep. 27, 2005) (\$61.5-million settlement of shareholders' suit).

NPAs are also not guaranteed. The more common reward for an FCPA voluntary disclosure is a deferred-prosecution agreement ("DPA") for the parent and a criminal plea for the subsidiary. *See, e.g.,* DOJ Press Release, "Schnitzer Steel Industries Inc.'s Subsidiary Pleads Guilty to Foreign Bribes and Agrees to Pay a \$7.5 million Criminal Fine" (October 16, 2006), available at <http://Portland.fbi.gov/dojpressre>. *See also* DOJ Press Release, "U.S. Resolves Probe Against Oil Company that Bribed Iranian Official" (October 13, 2006), available at <http://www.usdoj.gov/usao>. and DOJ Press Release, "Baker Hughes Subsidiary Pleads Guilty" (April 26, 2007), available at http://www.usdoj.gov/opa/pr/2007/April/07_crm_296.html.

DPAs involve the filing of criminal charges with an agreement that the charges will be stayed for a specific period, usually two or three years, and eventually dropped if the company complies with the DPA. Although DPAs give companies an opportunity to avoid prosecution, they subject the company to ongoing investigations, monetary penalties, follow-on civil litigation, and the imposition of a compliance monitor at the company's own expense. The ensuing government investigation under a DPA, moreover, tends to be significantly broader than the violation disclosed. A disclosure of a few improper payments by a small subsidiary in a small market can become a government investigation into the parent's worldwide activities — all paid for by the disclosing company.

Moreover, although the Filip Memorandum attempts to abate the pressure to waive privilege in order to receive cooperation credit, it remains to be seen whether this shift will have any practical effect on the expectation by DOJ that the cooperating company will waive. Whether this expectation will be further altered by the pending bill sponsored by Senator Specter, which seeks to prohibit the government from inducing companies to waive attorney-client or work-product privileges, also remains to be seen. Both the bill, introduced in the House of Representatives, and a companion bill, introduced in the Senate in January 2007 and reintroduced in June 2008, have yet to be acted upon and may not be in light of the DOJ's pre-emptive issuance of the Filip Memorandum.

Should the company breach the DPA — a determination entirely within the discretion of the DOJ — the company can be subject to both the original filed charges plus any other charges arising from information learned on account of the DPA and the privilege waiver.

The risk, moreover, that a company will breach a DPA or NPA is becoming increasingly high, as the DOJ is now attaching rigid timetables for completing internal investigations and implementing internal controls. For example, the DOJ, in agreeing not to prosecute Halliburton for FCPA violations by an acquired entity, required Halliburton to adhere to a strict disclosure and corrective schedule commencing with a review and reporting of high risk areas to be completed within ninety days of closing. See DOJ Op. Proc. Rel. 08-02, available at <http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2008/0802.html>. Similarly, the DOJ entered into a NPA with Paradigm B.V., requiring that specific internal controls be implemented within eighteen months. See DOJ Press Release, "Paradigm B.V. Agrees to Pay \$1 Million Penalty to Resolve Foreign Bribery Issues in Multiple Countries" (September 24, 2007), available at http://www.usdoj.gov/opa/pr/2007/September/07_crm_751.html.

In addition, the government is increasingly prosecuting individuals for FCPA violations, often stemming from conduct uncovered in the course of their employer's voluntary disclosure, leading companies to question whether, in voluntarily disclosing, they are inevitably exposing their executives to individual FCPA liability. See, e.g., DOJ Press Release, "Former Senior Officer of Schnitzer Steel Industries Inc. Subsidiary Pleads Guilty to Foreign Bribes," (June 29, 2007), available at http://www.usdoj.gov/opa/pr/2007/June/07_crm_474.htm. See also, *United States v. Titan Corporation*, No. 05-0314 (S.D. Cal., 2005).

ARE THERE BETTER TIMES AHEAD FOR DISCLOSING COMPANIES?

The purpose of the FCPA is to protect the integrity of the markets. If a good corporate citizen discovers a breach of that integrity, voluntarily discloses that breach, and takes significant corrective action to regain the trust of the market, it should not be penalized by greater government scrutiny than it would have had if it kept quiet. Nor should it be forced to disclose attorney-client communications, which could appear on the front page of *The New York Times* and damage the company and its shareholders, when a non-disclosing company can preserve these confidences. Recent outcomes of FCPA disclosures could be viewed as contrary to the Act's original intent. There is evidence, however, that this may be changing.

In November 2006, the Committee on Capital Markets Regulation, created to improve US capital markets, issued a report questioning the rash of recent indictments of companies that are not criminal enterprises throughout. See Interim Report of the Committee on Capital Markets Regulation (Nov. 30, 2006), available at <http://www.capmksreg.org>. The committee notes that prosecutors have not considered the fact that indictment can result in the liquidation of a company, leading to financial loss for innocent employees and shareholders. (In the case of companies that voluntarily disclose wrongdoing, such a "corporate death sentence" could seem particularly unjust). The current state of the economy serves to reinforce this concern.

CONCLUSION

Time will tell whether the Committee report, the Filip Memorandum, and the Senate bill sponsored by Senator Arlen Specter signify a trend toward a kinder treatment of companies that voluntarily disclose FCPA violations. For now, they bring companies a step closer to believing the DOJ's "unequivocal" assurances about the "real benefit" of voluntary disclosure.

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