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FCPA Voluntary Disclosure: Determining Whether and When to Self-Report

Weighing the Options, Understanding the Risks and Rewards, and Minimizing Penalties

WEDNESDAY, OCTOBER 29, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Edward J. Fishman, Partner, **K&L Gates**, Washington, D.C.

Kimberly A. Parker, Partner, **WilmerHale**, Washington, D.C.

James G. Tillen, Member, **Miller & Chevalier**, Washington, D.C.

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Foreign Corrupt Practices Act: Voluntary Disclosures

Ed Fishman
K&L Gates LLP
October 29, 2014

www.klgates.com

FCPA Enforcement Trends

- Historic levels of FCPA enforcement continue against companies and individuals
- Courts have upheld the broad definition of a “foreign government instrumentality” under the FCPA
- Over 100 companies under investigation
- More than half of DOJ enforcement actions triggered by voluntary disclosures
- Trend of multi-jurisdictional investigations and private litigation relating to FCPA issues continues unabated

Mandatory FCPA Disclosure Considerations

- Generally self-disclosure of a potential FCPA violation is not required
- However, disclosure may be legally required under certain circumstances
- Sarbanes-Oxley Act of 2002 may require disclosure of FCPA violations that preclude management from certifying the effectiveness of internal controls or that involve fraud

Mandatory Disclosure Requirements

- SAB 99's Qualitative Materiality standard could require disclosure of particularly egregious FCPA violations
- Foreign local law could require affirmative disclosure
- 10A Report from Outside Auditors could require Audit Committee to disclose potential violations to the SEC

Cooperation Credit Underpinnings

- DOJ memos on Prosecution of Business Organizations
  - "Promptly, completely and effectively disclose the existence of misconduct to the public, to regulators and to self-regulators"
- SEC: Seaboard Report (October 2001)
  - "Timely and voluntary disclosure of wrongdoing"
- FCPA Resources Guide
  - DOJ and SEC "place a high premium on self-reporting, along with cooperation and remedial efforts, in determining the appropriate resolution in FCPA matters"

Cooperation Credit Underpinnings

- US Sentencing Guidelines Manual 8C2.5(g)(1) (2010)

  "If an organization (A) prior to the imminent threat of disclosure or government investigation; and (B) within a reasonably prompt time after becoming aware of the offense, reported the offense to appropriate authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, [it shall receive a 5 point reduction in its total culpability score].

An Overview of the
Dodd-Frank Whistleblower Rules

Bounty provisions: overview

- Require payment of 10 to 30 percent of monetary sanctions obtained
  - To eligible whistleblowers
  - Who voluntarily provide
  - Original information to the SEC about a violation of the federal securities laws
  - Leading to enforcement action with sanctions exceeding $1 million

Bounty provisions: *who is eligible?*

- *Almost anyone* can be a Dodd-Frank whistleblower
- Can remain anonymous by reporting through counsel
- Excluded persons
  - Regulatory and law enforcement personnel
  - Independent public accountants (for information obtained in the course of an audit)
  - Non-natural persons
  - Lawyers - *under most circumstances*
  - Compliance personnel - *under some circumstances*
- No exclusion for persons involved in misconduct, unless they are criminally convicted
  - But no amnesty for whistleblowers

What kind of information must be provided?

- "Original" information
  - Not previously known to authorities
  - Derived from independent knowledge or analysis of a whistleblower
  - Cannot be derived exclusively from allegation made in judicial hearing, government investigation or from the news media
- Must be provided "voluntarily"
  - *i.e.*, *before* company's receipt of a request from the SEC or other authorities

What information does *not* qualify for a bounty?

- Excluded information - information obtained by:
  - Attorneys in the course of representation
    - *Unless* "up the ladder" or ethics exception applies
  - Compliance personnel
    - *Unless* company doesn't self-report within 120 days, or "reasonable basis to believe" that disclosure is necessary to prevent substantial injury to company or shareholders
- Whistleblower is eligible even if information was obtained in violation of:
  - Privileges other than attorney-client
  - Civil law
  - Criminal law (unless convicted of violation)

Dodd-Frank: protection against retaliation

- Employer may not discharge, demote, threaten or discriminate against whistleblower
- Whistleblower has federal right of action to enforce this provision
  - Remedies include:
    - Reinstatement
    - 2 x back pay
    - Costs

Key Issues and Risks

Tension with Corporate Compliance Efforts

- No requirement that employees first report concerns internally
  - SEC rule seeks to "not discourage" employees from first reporting to the company
  - SEC *"may"* (but need not) consider higher percentage awards for those who first report internally
- Internal investigations
  - Company personnel who learn of an issue by being questioned in an internal review can qualify for bounty
  - Compliance personnel become eligible for bounties where company fails to report to SEC within 120 days

Effect on "self-reporting" decisions

- Only the first person to report information will be eligible for a bounty
- Companies may seek to report first to obtain cooperation credit
- *Changing the calculus of the self-reporting decision*
  - Greater chance that violations will come to SEC attention
  - Greater risk that whistleblower will report before the company does

Proactive Steps

Encourage internal reporting

- Efforts to ensure that the company will be the first to know of potential wrongdoing
- Promote the expectation that the company wants to know about potential wrongdoing
- Implement effective internal reporting procedures
- Require internal reporting
- Enhance the *credibility* of internal reporting
  - Promptly investigate legitimate reports
  - Take appropriate remedial actions
- Do not tolerate retaliation in any form

Enhance corporate compliance systems

- More proactive / less passive
- Risk assessments
- Active monitoring of compliance
- Retrospective auditing of compliance

Reduce the risk of retaliation claims

- Limit the number of individuals aware of the identities of whistleblowers
- Do not seek to identify anonymous whistleblowers
- Provide training for managers at all levels
- Adhere to best practices for employee evaluations
  - Document fully and accurately
  - Review performance honestly and timely
- Exercise extra caution with employees who may use whistleblowing as an offensive strategy

Be prepared to respond to SEC Enforcement

- SEC Enforcement Staff may contact companies about whistleblower reports
  - May offer companies the opportunity to investigate and report back
    - Significant advantages in cost and control
  - Staff will need to be confident that company will cooperate and conduct credible inquiry
    - Advance planning can position company to make an appropriate response

Contact Information

Edward J. Fishman
K&L Gates LLP
1601 K Street, N.W.
Washington, D.C. 20006
Phone: 202-778-9456
Fax: 202-778-9100
E-mail: ed.fishman@klgates.com

Foreign Corrupt Practices Act Voluntary Disclosures: Factors Relevant to Whether to Self-Disclose

Kimberly A. Parker
Partner
Wilmer Cutler Pickering Hale and Dorr LLP
October 29, 2014

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Voluntary Disclosure – Overview

- FCPA statute does not require self-reporting
- Generally no obligation to self-report FCPA violations
  - Exception if the company is operating under prior legal agreement with the government that requires disclosure
  - SEC public disclosure rules may become relevant
- Both DOJ and SEC strongly encourage self-reporting
  - DOJ/SEC FCPA Resource Guide (November 2012): "Both DOJ and SEC place a high premium on self-reporting, along with cooperation and remedial efforts, in determining the appropriate FCPA resolution."
- "Carrot and stick" approach
  - Carrot: leniency/"credit"
  - Stick: threat of harsher treatment if conduct is revealed without a self-report

Voluntary Disclosure – Overview

- DOJ/SEC accept that some cases are not serious enough to warrant self-reporting:
  - Charles Cain, Deputy Chief, SEC FCPA Unit (2013): "If a company has a relatively small problem within an otherwise robust compliance environment, I would be surprised to hear about it. The further you get from that, the more I'd expect."
  - Assistant Attorney General Alice S. Fisher (2007): companies should voluntarily disclose "serious FCPA issues"
  - Mark Mendelsohn, head of DOJ FCPA Unit (2007): "[t]here are only so many hours in the day, and I would like to sleep some of them"

Voluntary Disclosure – Relevant Factors

Companies consider a mix of practical factors:

- Factor 1: Is the matter likely to come to the attention of DOJ/SEC in some other way?
  - If so, then report promptly; no downside and possible upside
  - Relevance of Dodd-Frank whistleblower law
  - How likely are investigations by law enforcement agencies outside the US?
- Factor 2: Is the matter serious because it involves large sums?
  - Large amounts of questionable payments -- either individually or cumulatively
  - Large amounts of business obtained or retained

Voluntary Disclosure – Relevant Factors

- Factor 3: Is the matter serious because it involves senior people?
  - Senior corporate officials participated, knew, or looked the other way
  - Senior government officials received questionable payments
- Factor 4: Is the matter serious because of its scope?
  - Was widespread among business units, or across geography
  - Lasted a long time
- Factor 5: Is the matter arguably less serious because it does not involve prosecutable acts of bribery and/or does not reflect more than an inconsequential breakdown or evasion of internal controls?

Voluntary Disclosure – Relevant Factors

- Factor 6: Is the matter serious because it involves a non-trivial breakdown in, or failure to implement, internal controls?
  - Did personnel in controllership positions participate, have knowledge, look the other way
- Factor 7: Is self-remediation a feasible and sufficient option? This includes:
  - Stopping questionable conduct
  - Conducting thorough internal investigation, led by competent, reasonably independent professionals
  - Addressing compromised controls
  - Disciplining personnel, including where appropriate, more senior executives
  - Correcting erroneous books and records to the extent reasonably feasible

Voluntary Disclosure – Relevant Factors

- Factor 8: Does either government agency have jurisdiction?
  - Involvement of issuer or domestic concern as opposed to just foreign subsidiary
  - Conduct touching the US
- Factor 9: Is the company the subject of another SEC/DOJ proceeding in which the agency may ask a general question the response to which would require disclosure of the matter?

Voluntary Disclosure – Relevant Factors

- Factor 10: Is the company risk-averse in the sense that it would rather "play it safe" by self-reporting even where arguably the balance of other considerations weighs against self-reporting?

- Factor 11: Is self-reporting, even where such reporting is not clearly warranted by other factors, more in keeping with the company's corporate culture and its values?

Voluntary Disclosure – Other Considerations

- Does the company have or want a particular relationship with SEC/DOJ?
  - Jason Jones, Assistant Chief of DOJ's FCPA Unit (2013): Companies can be "serial disclosers" – when certain companies build up enough credibility in the eyes of enforcement agencies, they regularly report issues and are then given room to handle them on their own, with little enforcement interference.
- Does the company have a history of previous violations?
- Is company an acquirer trying to avoid inheriting liability from a target?
- Is company contemplating an IPO or some other public market transaction?

Conclusion

- No one-size-fits-all answer:
  - Specific facts and circumstances must be considered in weighing voluntary disclosure
- Choice is not a self-report or nothing
  - If a company decides not to self-report, it still should take significant internal actions, including internal investigation and remediation measures
- Significant credit available even to companies that do not self-report if there is meaningful cooperation and remediation

Kimberly A. Parker | WilmerHale
1875 Pennsylvania Avenue NW
Washington, DC 20006 USA
+1 202 663 6987 (t)
+1 202 663 6363 (f)
kimberly.parker@wilmerhale.com

Weighing the Pros and Cons of FCPA Voluntary Disclosures

October 29, 2014

James G. Tillen
Miller & Chevalier Chartered

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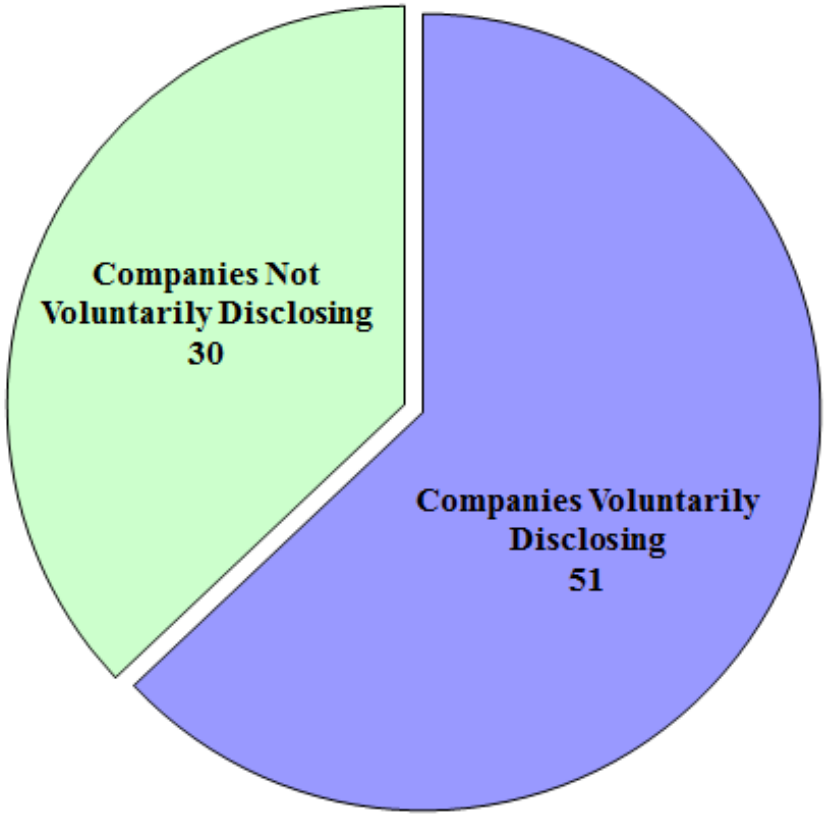
Discern the Difference

Disclosure vs. Non-Disclosure Quantifying the Benefits

- Although voluntary self-disclosures are a mitigating factor in the prosecution of FCPA violations that U.S. enforcement authorities have promised will bring "real benefits," statistics confirming such a benefit are difficult to generate for a number of reasons:
  - Settlement documents contain varying degrees of detail regarding illicit payments and the corresponding benefits obtained, complicating efforts to compare cases.
  - DOJ and SEC do not quantify the benefit of voluntary disclosure and settlement agreements do not specify the benefit derived solely from voluntary disclosure, rather, they discuss the total benefit derived from multiple factors (e.g., various types of cooperation).
  - DOJ and SEC may decline to pursue enforcement actions against companies that disclose, often leaving no public record of the declination.

Disclosure vs. Non-Disclosure Breakdown of Combined Enforcement (2007-2014)



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- Combined Enforcement Actions Resulting from Voluntary Self-Disclosures
- Combined Enforcement Actions Not Resulting from Self-Disclosures

Note: These statistics combine all related resolved enforcement actions involving a company and its subsidiaries and affiliates.

Disclosure vs. Non-Disclosure: Declinations

- Many have questioned the benefits obtained from voluntary self-disclosures, but one consideration frequently neglected by commentators is the rise in declinations by the DOJ/SEC.
  - In recent weeks, numerous DOJ officials have highlighted voluntary disclosure as a key factor in their decision to decline enforcement, noting that the DOJ has declined to prosecute a significant number of cases in recent years in recognition of companies' self-reporting ongoing cooperation.
  - Since 2008, we have identified at least 86 known declinations by the DOJ and/or SEC involving 65 companies, including a record 24 in 2013. Approximately 54% of these companies self-disclosed the underlying conduct.
  - In Q3 2014, we identified 6 known declinations by the DOJ and/or SEC, 5 of which involved companies who self-disclosed.

Disclosure vs. Non-Disclosure: Panalpina Comparison

- The Panalpina resolutions, which include the settlement of both disclosed and non-disclosed violations and several declinations, provide an opportunity for analysis. Examining the dispositions of the companies:
  - In at least five instances, the DOJ or SEC declined to pursue enforcement of companies that self-disclosed.
  - Average monetary penalty/disgorgement for violations that were not voluntarily disclosed was approx. $41.6 million compared with approx. $13.98 million for violations that were disclosed (incl. declinations).
  - Average monetary penalty/disgorgement for violations that were **not voluntarily** self-disclosed was **four** times the average profit attributed to the improper payments.
  - Average monetary penalty/disgorgement for violations that were **voluntarily** self-disclosed (including declinations) was **two** times the average profit attributed to the improper payments.

Disclosure vs. Non-Disclosure: Panalpina Comparison Cont'd

- For example, a comparison of two companies settling Panalpina-related charges:
  - Royal Dutch Shell, which **did not voluntarily disclose**, received a combined penalty/disgorgement of approx. $48.15 million ($30m – DOJ, $18.15m – SEC) for offenses resulting in an estimated $14.15 million in profits from illicit payments.
    - Monetary penalties were nearly **3.5 times the estimated profits**.
  - Tidewater, which **did voluntarily disclose**, received a combined penalty/disgorgement of approx. $15.65 million ($7.35m – DOJ, $8.3m – SEC) for offenses resulting in an estimated $7.2 million in profits from illicit payments.
    - Monetary penalties were approximately **2.1 times the estimated profits**.

Disclosure vs. Non-Disclosure: Monetary Penalties

- An analysis of combined enforcement actions (and known declinations) with the DOJ and SEC since 2007 shows:
  - The average combined monetary penalty/disgorgement and prejudgment interest for violations that were **not voluntarily** self-disclosed was about **2.6** times the average profit from the improper payments.
  - The average combined monetary penalty/disgorgement and prejudgment interest for violations that were **voluntarily** self-disclosed was about **2.1** times the average profit from the improper payments.
- Thus, when compared to the average profit from the bribes, the average monetary penalty/disgorgement for voluntarily self-disclosed violations was nearly **20% lower** than the penalty for violations not voluntarily disclosed.

Disclosure vs. Non-Disclosure: Monetary Penalties Cont'd

- From 2007 through 2014, the average combined monetary penalty/disgorgement for violations that were not voluntarily disclosed was approx. $96.6 million compared with approx. $27.4 million for violations that were disclosed (not including declinations).
- Of the ten largest combined enforcement actions to date (including fines, disgorgement and pre-judgment interest), only one resulted from a voluntary disclosure (Alcoa, which ranks 5th with a combined $384 million).

Disclosure vs. Non-Disclosure: Monetary Penalties Cont'd

- Analysis of Sentencing Guidelines calculations suggests voluntary disclosure can result in criminal fines significantly lower than suggested fine range:
  - Alcoa (2014) – reduction of 53%
  - Diebold (2013) – reduction of 30%
  - Pfizer (2012)– reduction of 34%
  - BizJet (2012) – reduction of 31%
  - Pride (2010) – reduction of 55%

Disclosure vs. Non-Disclosure: Monetary Penalties Cont'd

- A review of enforcement actions that were **not self-disclosed** suggests companies can nevertheless receive significant credit for cooperating and engaging in meaningful remediation. For example:
  - ZAO Hewlett Packard (2014) – reduction of 32%
  - Parker Drilling (2013) – reduction of 20%

- Significant credit can even be obtained where a company has **initially resisted** the DOJ and SEC's enforcement efforts.
  - Bilifinger SE (2013) – Began to cooperate "albeit at a late date" and received a credit in its sentencing calculations.
  - JGC Corp. (2011) – after "initially declining to cooperate," JGC began to work with DOJ and received a reduction of 30%.

Potential Benefits of Disclosure

- Voluntary disclosure is cited as a mitigating factor in SEC Seaboard Report, DOJ Attorney Manual, and FCPA Guide.
- Evidence that voluntary disclosures result in lower fines.
- Government is more likely to rely on results of company's internal investigation rather than conduct its own investigation.
- Provides opportunity to present issues in best light, including the chance to:
  - Assert defenses
  - Argue mitigating circumstances, such as remedial efforts
- Provides opportunity to assist government in focusing investigation, so as not to unduly disrupt business operations.

Hazards of Disclosure

- No benefit if agencies view disclosure as:
  - Not voluntary – such as when disclosure follows a whistleblower threat, foreign investigation, media reports.
  - Untimely – significant time elapsed since allegations were made or investigation initiated.
  - Incomplete – omitting significant relevant information.
- Disclosure can trigger a broader investigation – beyond scope of activities disclosed (e.g., other business units, other countries, other individuals).
  - *See*, Avon Products Inc., which voluntarily disclosed possible FCPA violations in China in 2008, only to have the investigation expand to include at least 12 additional countries at a cost of $344 million through mid-2014, with an expected $135 million settlement on the horizon.

Hazards of Disclosure Cont'd:

- Collateral consequences:
  - Possible waiver of privilege
  - Damage to reputation
  - Decrease in share value
  - Could trigger parallel investigations by foreign authorities
  - Could trigger civil suits
  - Penalties (criminal and civil fines, disgorgement, compliance enhancements, monitor)
  - Costs of resolving (e.g., dedication of internal resources, outside counsel)
  - Company employees targeted

If Not Disclosing:

- Ensure misconduct has stopped
- Conduct sufficiently thorough investigation
  - Consider use of outside counsel to lend credibility
- Retain files of investigation and results
- Conduct and document significant remediation
  - Disciplinary measures
  - Enhancements to controls and compliance program
  - Periodic testing
- Hold breath

James G. Tillen
Member
Miller & Chevalier
655 Fifteenth Street, N.W.
Suite 900
Washington, DC 20005
202.626.6068
202.626.5801
jtillen@milchev.com

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