

Government Investigations: Evaluating the Settlement Options

Using Deferred Prosecution and Non-Prosecution Agreements,
Plea Agreements, and Declinations to Resolve Agency Enforcement Actions

WEDNESDAY, AUGUST 22, 2012

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

Today's faculty features:

Matthew T. Reinhard, Member, **Miller Chevalier**, Washington, D.C.

Thomas A. Sporkin, Partner, **BuckleySandler LLP**, Washington, D.C.

Lara Covington, Attorney, **Morvillo Abramowitz Grand Iason Anello & Bohrer**, Washington, D.C.

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**Government Investigations:
Evaluating the Settlement Options**

Wednesday, August 22, 2012

**Matthew Reinhard
Miller & Chevalier
mreinhard@milchev.com
(202) 626-5894**

Resolving a DOJ Investigation

- Types of DOJ Resolutions:

- Trial
- Plea agreement
- DPA
- NPA
- Declination



- Negotiation: Vehicle for resolution short of trial is the product of negotiation

To Trial or...?



- Context of Negotiations:

- A company can always demand that the prosecution try its case in chief, but in practice many corporate defendants find the potential risks and uncertainty of a trial unacceptable
- Trial could provide the opportunity to contest any baseless charges or unsupported statutory interpretations (*Harris Corp.*)
- However, the adversarial nature of trial can dramatically affect a company's business operations and may end up expanding scope of the investigation and result in additional charges (*Nexus Technologies*)

Negotiated Resolutions: Plea Agreement

- Overview:

- Company agrees to plead guilty to some charges in exchange for some benefit.
- May require company to consent to fine, continue cooperating, implement compliance program, and possibly consent to a monitor
- Court must approve terms of agreement

- Benefits:

- Avoids risk that can accompany jury trial (e.g., hefty sentences)
- Generally involves some benefit, which can include *inter alia*:
 - ❖ Reduction in scope of investigation, dismissal of some of charges or a reduction in their severity
 - ❖ Recommendation of reduced sentence, agreement duration, etc.

Plea Agreement (Cont.)

- Drawbacks:

- If company violates agreement during its term, DOJ may pursue additional charges while company may not withdraw guilty plea
- Agreement could result in collateral consequences, for instance:
 - ❖ Debarment by the U.S. government or another country or institution (e.g., World Bank) (*Siemens AG*)
 - ❖ Prosecution by foreign governments (*KBR; Siemens AG*)
 - ❖ Private civil litigation (e.g., shareholder derivative suits, etc.) (*BAE Systems; Siemens AG*)
- **Court is not bound to accept DOJ's recommendations**

Negotiated Resolutions: Deferred Prosecution Agreement

DEFERRED PROSECUTION AGREEMENT

Defendant [REDACTED]), by its undersigned attorney

- Overview:

- DOJ files charges in court but agrees to defer prosecution
 - ❖ If company complies with obligations under agreement, DOJ will file to dismiss charges at end of DPA term.
- Typically must admit to facts, consent to fine, continue cooperating, implement compliance program, and possibly consent to a monitor
- Court must approve terms of agreement

- Benefits:

- Enables a company to avoid a formal conviction
- Frequently involves some additional benefits, which can include:
 - ❖ Reduction in scope of investigation, dismissal of some of charges or a reduction in their severity
 - ❖ Recommendation of reduced sentence, etc.

Deferred Prosecution Agreement (Cont.)

- Drawbacks:

- Criminal information is still filed in court
- Failure to abide by its DPA may subject a company to prosecution on the deferred charges (*Aibel Group Ltd.*)
- DPA could nevertheless still result in collateral consequences, for instance:
 - ❖ Debarment by the U.S. government or another country or institution (e.g., World Bank)
 - ❖ Prosecution by foreign governments (*Johnson & Johnson; Tidewater*)
 - ❖ Private civil litigation (e.g., shareholder derivative suits, etc.) (*Johnson & Johnson; Panalpina World Transport*)
- Court is not bound to accept DOJ's recommendations (though it traditionally does)

Negotiated Resolutions: Non-Prosecution Agreement

On the understandings specified below, the United States Department of Justice, Criminal Division, Fraud Section (the "Department") will not criminally prosecute [REDACTED]

- Overview:

- DOJ agrees not to criminally prosecute a company in exchange for company abiding by certain obligations for term of agreement.
- Typically must admit to facts, consent to fine, continue cooperating, implement compliance program, and possibly consent to a monitor

- Benefits:

- No requirement that court approve of agreement
- No formal charges ever filed
- Terms of NPA are generally more favorable vis-à-vis misconduct (e.g., reduced scope of investigation, reduced fines, imposition of corporate monitors less often, etc.)
- While collateral consequences still possible, with no formal charges brought less likely to involve imposition of debarment, etc.

Non-Prosecution Agreement (Cont.)

- Drawbacks:

- If company violates NPA during its term (usually 1 to 3 years), DOJ may pursue charges for underlying activity
- Agreement could result in collateral consequences
 - ❖ Prosecution by foreign governments (*Halliburton; Noble*)
 - ❖ Private civil litigation (e.g., shareholder derivative suits, etc.) (*Halliburton*)

Negotiate Resolutions: Declinations

- Overview:

- Decision by DOJ to conclude an investigation (either formal or informal) into potential violations without bringing an enforcement action.
- Most desirable outcome of any investigation for a company; there are few, if any, drawbacks.
- Historically, DOJ has not publicized these decisions, so it is difficult to know how frequently and on what basis they occur
- In response to criticisms about lack of transparency, DOJ has publicized several recent declination decisions (*Morgan Stanley; Wyeth*)
- Analysis by M&C has shown significant uptick in known declination decisions by DOJ with regards to FCPA investigations in recent years (primarily disclosed by public corporations in SEC filings)
- DOJ has publicly claimed that it has declined to prosecute “a record number of cases” in recent years.



Trends in Negotiated Settlements

- Plea agreements are still primary vehicle for resolving government investigations of corporate entities, but use has dropped markedly:
 - Historically used more than 4-5 times as often as DPAs/NPAs
 - Ratio has fallen to less than twice as much in 2012
- Since 2000, DOJ has entered into over 1,800 corporate plea agreements compared with only around 250 corporate DPAs/NPAs—a ratio of about 14%.
- Negotiated pleas are here to stay—U.K. MoJ in process of developing U.K. system of DPAs to assist in prosecuting economic crime

Pros and Cons in Negotiating Settlements

- Advantages:

- Trials are complicated, drawn-out, unpredictable, and expensive endeavors. Negotiated settlements provide both enforcement authorities and their corporate targets with more flexibility and a greater measure of predictability and control:
 - ❖ Assisting enforcement authorities by encouraging cooperation and sparing scarce enforcement resources; and
 - ❖ Providing a benefit to companies by providing them with more control over the process and giving them incentives to cooperate.

- Disadvantages:

- Alternatives to cooperation are stark, so companies may feel pressure to admit to violations they do not feel they committed
- Negotiation process is somewhat opaque and non-transparent and judicial oversight (particularly for NPAs) is limited



Government Investigations: Evaluating the Settlement Options

Thomas Sporkin

1250 24th Street NW, Suite 700

Washington, DC 20037

tsporkin@bucklesandler.com

202-349-8000

The SEC's use of NPAs and DPAs

Outline

- Common resolutions to SEC investigations
- SEC cooperation initiative
- Individual cooperation elements
- Entity cooperation elements
- How SEC DPAs and NPAs differ
- The first SEC NPA and DPA
- Complete pass vs. DPA
- Fannie and Freddie NPAs are unique
- The benefits of DPAs and NPAs over C&Ds and Injunctions

Resolving an SEC Investigation

- SEC Resolutions
 - Injunction
 - Cease & Desist Order
 - Report of Investigation / 21(a) report
 - **Deferred Prosecution Agreement**
 - **Non-Prosecution Agreement**
 - No Action
- Additional Relief
 - Monetary penalties
 - Disgorgement of ill-gotten gains with interest
 - Undertakings

SEC Cooperation Initiative 2010

- Announced by Enforcement Director Khuzami in January 2010
- To improve the quality, quantity, and timeliness of information and assistance it receives, the SEC will consider resolving matters with:
 - deferred prosecution agreements
 - non-prosecution agreements
 - (and in some instances no action)

SEC Considerations for giving cooperation credit to individuals

Individual Cooperation Elements set out in AXA Rosenberg Release (2012)

- **Background:** AXA Rosenberg, an institutional money manager that specialized in quantitative investment strategies, concealed a material error in the computer code of the model it used to manage client assets. The error impacted more than 600 client portfolios and caused approximately \$217 million in losses.

- **Elements:** one year after bringing an Enforcement action against the entity, the SEC issued a litigation release that explained why it did not bring an action against the individual who provided the SEC with the information that led them to the wrongful conduct. In that release, the SEC set forth the factors that comprise “substantial cooperation”
 - Timely report
 - High quality information
 - Allow SEC to conserve resources
 - First through the door
 - Assistance without conditions
 - Underlying matter involves concealment

SEC Considerations for giving cooperation credit to entities

Entity Cooperation Elements set forth in SEC's Seaboard Report (2001)

- **Background:** The controller of Chestnut Hill Farms, a division of publicly traded Seaboard Corp. had made inaccurate entries in Chestnut Hill Farms' books and records, causing assets to be overstated and expenses to be understated. Thereafter, she tried to conceal her actions by making additional improper entries. After being questioned by Seaboard's internal auditors, she confessed her wrongdoing. On its own, Seaboard dismissed the controller, hired outside counsel to conduct an internal investigation, turned the investigation report over to the SEC, and enhanced its internal reporting processes. The SEC filed an action against the controller, but did not file an action against the corporation.
- **4 Elements:** the SEC issued a report of investigation that set forth what entities should do if they want cooperation credit. The report addresses 13 factors and 4 principles:
 - Self-policing
 - Self-reporting
 - Cooperation
 - Remediation

How SEC DPAs and NPAs differ

DPA Elements (Tenaris and Amish Fund):

- Acceptance of Responsibility
- Cannot contest SEC's factual recitation
- Cannot Deny Facts (except in legal proceedings against parties other than the Commission)
- Must continue to cooperate
- Must Agree to undertakings and/or prohibitions
 - Undertakings can include the payment of disgorgement

NPA Differences (Carter's)

- No Statement of Facts
- "Acceptance of responsibility" language not included
- Agreement not to "deny" goes to "any aspect of the agreement" rather than a set of facts
- Modest undertakings

The first SEC Non-Prosecution Agreement

- **2010: Non Prosecution Agreement**

Background: Executive VP of publicly traded Carter's, Inc. was secretly giving discounts to a retailer but wasn't causing the discounts to be recorded appropriately on the books and records of Carter's causing an understatement of its expenses and a material overstatement of its net income. Because each of the following factors was met, the SEC decided to use, for the first time, a Non-Prosecution agreement with Carter's:

- Prompt and complete self-reporting
- **Misconduct relatively isolated**
- Cooperation is exemplary and extensive and includes a thorough and comprehensive internal investigation
- Extensive and substantial remedial actions

The first SEC Deferred Prosecution Agreement

- **2011: Deferred Prosecution Agreement** (with undertakings to pay disgorgement, implement a code of conduct, and provide anticorruption training)

Background: Publicly traded Tenaris retained an agent to help it bid on pipeline contracts with OAO, a Uzbekistan state-owned company. The agent obtained confidential information about competitors' bids from OAO officials, supplied it to Tenaris and arranged for Tenaris to submit revised bids. **Tenaris understood that the payments it made to the agent were used, in part, to obtain the bid information and to receive permission to submit revised bids.** Tenaris made over \$4.7 million in profits from the pipeline contracts. Because the SEC found that Tenaris had done the following, the SEC agreed to resolve the matter with a Deferred Prosecution agreement:

- Immediate self-report
- Thorough internal investigation
- Full cooperation
- Extensive efforts at correcting the violations
- Enhanced anti-corruption procedures and training

SEC “Complete Pass” vs. SEC DPA

- **April 2012 - Complete Pass**
- SEC decides not to file any action against Morgan Stanley in recognition of their “FCPA compliance program and internal controls.” The SEC alleged that a **rogue** Morgan Stanley executive had obtained advantageous investment opportunities personally and for Morgan Stanley through a friendship with a Chinese Official. The SEC recognized the following in deciding to charge the individual but not charge Morgan Stanley:
 - Morgan Stanley had an FCPA compliance training program
 - The rogue employee received the training
 - The rogue employee received 35 FCPA compliance reminders
 - Morgan Stanley required rogue employee to certify compliance with FCPA
 - Morgan Stanley compliance officer specifically informed rogue employee of risks associated with doing business with state-owned entity
- **July 2012 0- Deferred Prosecution Agreement** (with undertaking to make disclosures)
- SEC enters into a deferred prosecution agreement with the Amish Helping Fund (AHF), a non-profit corporation that offers securities to fund mortgage and construction loans to young Amish families. The SEC alleged that the **AHF’s offering memorandum had not been updated for 15 years and contained material misrepresentations** (but no evidence of harm). The SEC noted that as soon as the AHF was informed of the wrongful conduct:
 - AHF updated and corrected its offering memorandum and provided existing investors with a copy
 - AHF offered all existing investors the right of rescission
 - AHF retained an independent certified public accountant to audit
 - AHF registered its securities offerings with state of Ohio

SEC Unique Non-Prosecution Agreements – Fannie and Freddie

- In December 2011, the SEC entered into a non-prosecution agreement with Fannie Mae and Freddie Mac
- The agreement looked more like a DPA than an NPA (with the sole exception that Fannie and Freddie did not have to pay any money)
- The SEC alleged that the companies made materially misleading statements reflecting that they had minimal holdings of subprime mortgage loans
- The SEC noted that it was in the public interest to enter into the agreement and not seek monetary relief:
 - The government provides financial support for Fannie and Freddie
 - Defense of an action by either party could impose substantial costs on taxpayers

The Benefits of SEC DPAs & NPAs over C&Ds and Injunctions

- DPAs and NPAs have less stigma than Injunctions and C&Ds because they are not “Enforcement Actions”
- Monetary Penalties are usually part of injunctive actions and C&D’s but have not yet appeared in SEC DPAs and NPAs (though disgorgement has been part of a DPA)
- No third party scrutinizing the agreement
 - Neither admit nor deny debate avoided
 - Violate the law injunction debate avoided
 - Public interest judicial review debate avoided
- Certainty when filing
 - No surprises from court when papers are filed (such as order for additional discovery)
- Far less risk that factual recitations will be accepted as admissions in related private litigation
 - In rejecting Goldman Sachs’ motion to dismiss class action suit arising out of Abacus CDO transaction, Judge gives weight to the “admissions” in Goldman’s consent to the SEC action

Strategies for Resolving Government Investigations by Negotiated Resolution

Lara Covington

lcovington@maglaw.com

202.349.0124

August 22, 2012

Strategies for a Successful Settlement

- Settlement Postures
- Strategies in Preparing for Settlement
- Strategies to Avoid a Plea Agreement or SEC Enforcement Action
- Strategies for Negotiating Settlement Terms

Settlement Postures

- Settlement Postures
 - ▣ Company initiates investigation
 - ▣ Government initiates investigation
- If company initiates, begin discussing disclosure and potential settlement options once criminal conduct discovered
- If government initiates, establish cooperative relationship and report back early and often
- In both scenarios, conduct thorough investigation and begin remedial measures contemporaneous with investigation

Strategies in Preparing for Settlement

- Analyze improper conduct and compliance weaknesses discovered
- Consider and initiate appropriate remedial measures as soon as possible
- Identify settlement goals, such as:
 - ▣ Avoiding a plea agreement or injunction/C&D
 - ▣ Avoiding a monitor
 - ▣ Protecting the parent
 - ▣ Being able to conduct business under anticipated settlement requirements

Strategies in Preparing for Settlement

- Remedial Measures:
 - ▣ Disciplinary action against top management and personnel responsible for illegal conduct
 - ▣ Enhanced compliance policies and procedures
 - ▣ Enhanced internal controls
 - ▣ Enhanced or more widely distributed compliance training
 - ▣ Heightened review of business transactions at issue
 - ▣ Restructuring or shutting down business unit or entity involved

Strategies to Avoid a Plea Agreement

- Factors relevant to avoiding a plea agreement:
 - Voluntary and timely disclosure
 - Cooperation with government
 - Collateral consequences that would result to innocent third parties
 - Impact of mandatory debarment on business
 - Reputational harm to company
 - Financial consequences that could be triggered
 - Remedial actions taken by the company
- USAM 9-28.300

Strategies to Avoid SEC Enforcement Action

- Factors relevant to avoiding an injunction or cease-and-desist order:
 - ▣ Speedy and effective response to misconduct
 - ▣ Voluntary and timely disclosure
 - ▣ Cooperation with government
 - ▣ Full report to Audit Committee and Board
 - ▣ Thorough independent investigation
 - ▣ Thorough and probing written report
 - ▣ Remedial actions taken by the company
- Seaboard Report, Exchange Act Release 44969

Strategies for Negotiating Settlement Terms

- Avoiding a monitor:
 - ▣ Strong internal controls and compliance program
 - ▣ Extraordinary cooperation (Data Systems)
- Alternatives:
 - ▣ Self reporting or independent compliance consultant (Marubeni, Biomet)
 - ▣ Increased fine (Orthofix)
- If monitor, consider:
 - ▣ Length of term
 - ▣ Scope of review
 - ▣ Privilege issues

Strategies for Negotiating Settlement Terms

- ❑ Compliance language (Schedule C)
- ❑ Proper admissions
- ❑ Possible public dissemination (AIG)
- ❑ Amount of fine (e.g., Orthofix)
- ❑ Reporting Obligations (e.g., PPG)
- ❑ Other terms