

THE DEFENDER

LEGAL ISSUES IN SECURITIES LITIGATION,
GOVERNMENT ENFORCEMENT AND WHITE COLLAR DEFENSE

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Are You Covered?

In this issue of *the Defender*, for those facing securities class actions, derivative lawsuits, or government investigations, we provide guidance on accessing your insurance coverage to assist with associated costs. We also provide an insurance coverage checklist to assist with a quick and straightforward review of your coverage; an update on the continuing explosion of Foreign Corrupt Practices Act (FCPA) enforcement activity, including record-setting fines and several individual indictments with potential prison sentences; and a primer on what to expect and how to protect your rights when responding to search warrants or subpoenas.

There has been a recent surge in securities class action and derivative lawsuits filed by plaintiffs in the wake of the stock options backdating investigations, “Madoff” financial scandal, and the renewed focus on the FCPA by the Department of Justice and Securities and Exchange Commission. Corporate America should expect the wave of sophisticated investors bringing novel claims relating to complex securities issues in this atmosphere of changing regulatory and administrative oversight to continue. Executives, financial officers, risk managers, and others with high-level management positions have found themselves and their companies in the cross-hairs of Section 10-b(5) and 11 suits; and the subjects and targets of SEC and DOJ investigations directed at corporate “gatekeepers” who are perceived to have contributed to the company’s alleged misconduct and financial downturn.

Against this backdrop, it is clear that corporate and individual insureds must be vigilant to obtain and protect their insurance rights. Indeed, when defense costs can amount to hundreds of thousands or even millions of dollars, the benefits provided by a company’s Directors and Officers Liability, Errors and Omissions, and Fiduciary Liability Insurance policies can mean the difference between acceptable quarterly reporting and financial disaster. A simple misstep on insurance coverage issues can cost a corporation its valuable coverage rights. Accordingly, we at *the Defender* have teamed up with our colleagues in Howrey’s top-ranked Insurance Coverage practice to provide you with additional guidance in navigating the insurance issues commonly presented by the defense of securities, government enforcement, and white-collar criminal matters.

How to Access Your Insurance Coverage to Defend an Investigation

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Whether an investigation is commenced by a state government or the federal government, the defense costs associated with the investigation can be very significant. In many cases, insurance policies will cover the defense costs relating to an investigation. Consequently, one of a company's top priorities when faced with an investigation – after hiring excellent defense counsel – should be accessing their insurance coverage.

The process of getting an insurer to promptly pay the defense costs can be difficult. A policyholder that is mindful of a few issues that commonly arise in seeking coverage for an investigation is in a much better position to obtain prompt payment of defense costs. This article addresses four common obstacles to obtaining prompt payment of defense costs.

I. IS THERE A “CLAIM”?

One of the threshold issues in assessing whether a government investigation is covered is whether a “claim” has been made. Policy definitions of “claim” vary significantly. Some policies broadly define “claim” to include “a civil, criminal, administrative or regulatory investigation of an Insured Person ...”¹ This definition is quite clear and will cover most investigations. Other policies, however, do not include such explicit language. Courts have reached different results on whether an investigation constitutes a “claim” when the language is not explicit, focusing on the precise policy language at issue and the nature of the governmental action. One favorable decision for a policyholder is *National*

Stock Exchange v. Federal Ins. Co. (“*National Stock Exchange*”).² In *National Stock Exchange*, the policy defined “claim” to include “a formal investigative order or other similar document.”³ The court ruled that an SEC “Order Directing Private Investigation and Designating Officers to Take Testimony” was a “claim” covered under the policy.⁴ In doing so, the court rejected the insurer’s argument that a claim did not arise until a proceeding was commenced directly against the insured.⁵

A related issue is whether a subpoena for documents or testimony from a governmental entity constitutes a “claim.” Some courts held that there is a “claim” when the governmental entity conducting an investigation issues a subpoena for documents or testimony. For example, in *Minuteman Int., Inc. v. Great American Ins. Co.*, the policy defined a claim to include “a written demand for monetary or nonmonetary relief.”⁶ The court ruled that an SEC subpoena fell within this definition of a claim because the investigation had sought “nonmonetary relief” in the form of documents and testimony.⁷ However, other courts have not allowed coverage for defense costs incurred in responding to a subpoena. In *Center for Blood Research, Inc. v. Coregis Ins. Co.*, the court declined to rule that a policyholder’s defense costs associated with responding to an investigative subpoena issued by the United States Attorney for the District of Massachusetts constituted a “claim” under the policy.⁸ The subpoena was served on the policyholder merely in its capacity as the custodian of records and there was no indication that the policyholder was the

FOOTNOTES

¹ *AT&T Corp. v. Faraday Capital Ltd.*, 918 A.2d 1104, 1107 n.7 (Del. 2007).

² *National Stock Exchange v. Federal Ins. Co.*, No. 06C1603, 2007 WL 1030293 (N.D. Ill. Mar. 30, 2007)

³ *Id.* at *3.

⁴ *Id.* at *5

⁵ *Id.* See also *Polychron v. Crum & Forster Ins. Cos.*, 916 F.2d 461 (8th Cir. 1990) (legal fees incurred for defending target of grand jury investigation constituted covered defense costs); *Richardson Electronics, Ltd. v. Federal Ins. Co.*, 120 F. Supp. 2d 698 (N.D. Ill. 2000) (Justice Department investigation was claim).

⁶ *Minuteman Int., Inc. v. Great American Ins. Co.*, No. 03C6067, 2004 WL 603482, at *3 (N.D. Ill. Mar. 22, 2004)

⁷ *Id.* at *7.

⁸ In *Center for Blood Research, Inc. v. Coregis Ins. Co.*, 305 F.3d 38 (1st Cir. 2002)

target of any investigation.⁹ Thus, courts have reached different results about whether insurance policies cover the costs of complying with a subpoena issued by a government entity.

II. GIVE PROMPT NOTICE AND PAY ATTENTION TO THE WORDING OF YOUR NOTICE

When a government investigation is initiated, a policyholder should notify its insurers in a timely manner. In some situations, failure to provide prompt notice could preclude coverage altogether. In fact, in many states, courts will decide a late notice defense under a directors and officers' policy without regard to whether the insurer was prejudiced by the purported late notice.

Notice provisions typically describe how to give notice of claims and situations that might give rise to a claim. Policyholders should be careful about how they give notice of a claim. In the event of a government investigation, policyholders may have to decide whether to notify their insurers of a "claim" or "potential claim." Once a "potential claim" or "claim" is noticed, subsequent policies typically will not cover the noticed claim or subsequent claims. Further, the policyholder's characterizations in that letter may influence coverage determination by the insurer. Therefore, a policyholder needs to give prompt notice and to carefully consider the content of the notice letter.

III. POLICY EXCLUSIONS TYPICALLY DO NOT PRECLUDE A DEFENSE

Insurers also may try to invoke certain policy exceptions to avoid paying for the defense costs associated with government investigations. Exclusions in an insurance contract are construed strictly to give the interpretation most beneficial to the insured.¹⁰ If an exclusion is ambiguous, it is construed against the insurer.

Given implicit or explicit allegations of wrongdoing that may be part of a government investigation, insurers are most likely to invoke so-called "personal conduct" exclusions. These exclusions relate to illegal profits, fraud, or intentional violations of law. For a number of reasons, these types of exclusions normally should not excuse an insurer from its obligations to either defend or reimburse defense costs while an investigation is ongoing.

As an initial matter, most director and officers' insurance policies include provisions that require the insurer to advance defense costs at least until the final disposition of the claim. While a policyholder may have to repay the insurer for defense costs after a final disposition of the claim, at the very least these types of provisions allow a policyholder to put up a proper defense while the claim is pending. In *Sun-Times Media Group, Inc. v. Royal & Sunalliance Ins. Co. of Canada*, the court considered three insurers' claims that personal conduct exclusions relieved them of their obligations to pay defense costs.¹¹ The court ruled that even if a personal conduct exclusion might apply at a later time, "this still does not prevent the advancement of defense costs at the present time because the policy provides that the Insured must pay back money they received but were not entitled to."¹² In order to excuse its obligation to advance defense costs, the insurer would have to "unequivocally" show that all of the allegations in the complaint fell within the personal conduct exclusions.¹³ Therefore, insurers cannot avoid coverage under the language of most personal conduct exclusions until the final adjudication of the claim. Until that time, the insurer must continue to advance defense costs.

Policyholders should be aware, however, that some courts have taken a broad view of "final adjudication." In *Millennium Partners, L.P. v. Select Ins. Co.*, a policyholder brought an action against its insurer for fail-

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FOOTNOTES

⁹ *Id.* at 42-43.

¹⁰ See e.g., *Altstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 400 (D. Del. 2002) ("illegal profit" exclusion

should be construed strictly).

¹¹ *Sun-Times Media Group, Inc. v. Royal & Sunalliance Ins. Co. of Canada*, No. 06C-11-108, 2007 WL 1811265, at

*1 (Del. Super. June 20, 2007)

¹² *Id.* at *11-12.

¹³ *Id.* at *11.

ure to reimburse defense costs incurred in connection with an investigation by the New York Attorney General and the SEC.¹⁴ To avoid possible criminal charges, the policyholder entered into settlement agreements with these two entities.¹⁵ The settlement agreements contained factual findings that, among other things, the policyholder had “devised and carried out a fraudulent scheme,” but also provided that the policyholder was consenting to the settlement “without admitting or denying the findings.”¹⁶ As part of the settlement, the policyholder was required to pay nearly \$150 million in “disgorgement.” After the settlement agreements were signed, the insurer refused to reimburse defense costs because the settlement agreement and the disgorgement amounted to a finding that the policyholder had improperly acquired the money, which was not covered under the policy.¹⁷ The court agreed with the insurer and denied the policyholder’s request for reimbursement of defense costs associated with the investigation.¹⁸

Finally, many policies contain a severability clause. This type of clause typically prohibits an insurer from

coverage. This can be very important during a government investigation of a corporation where a large number of employees, officers, and directors, all with varying degrees of knowledge concerning the events that gave rise to the investigation, are involved. In the aftermath of the Tyco financial scandal, former CEO Dennis Kozlowski obtained declaratory relief obligating his insurer to pay his defense costs in several actions (criminal and civil) by arguing, in part, that the policy’s severability clause prevented the insurer from imputing to Mr. Kozlowski a guilty plea by another Tyco director.¹⁹

IV. INSURERS MAY ATTEMPT TO USE BILLING GUIDELINES TO DIMINISH THEIR CONTRIBUTION TO THE DEFENSE

Once the investigation has begun and notice has been given to the insurer, some insurers will agree to defend. However, many insurance companies will attempt to limit their responsibility by unilaterally imposing some sort of restrictions or limitations on the defense costs that they will pay. This is done by unilateral imposition of billing

[I]n many states, courts will decide a late notice defense under a directors and officers’ policy without regard to whether the insurer was prejudiced by the purported late notice.

imputing to an insured person any statement made or knowledge possessed by another insured person for the purpose of determining whether coverage is available. While this may mean that one or more insured persons may not be entitled to defense costs because of that person’s conduct, that conduct will not be imputed to the other insured persons for purposes of determining

guidelines or litigation guidelines. The guidelines prohibit billing for certain legal costs, such as the use of online legal research databases, local travel, and interoffice conferencing. Insurers may also refuse to pay billing rates above a certain rate, which is usually below the level charged by most defense attorneys. Especially in cases as complex as government investigations, these billing

FOOTNOTES

¹⁴ *Millennium Partners, L.P. v. Select Ins. Co.*, No. 601878/2007, 2009 WL 586127, at *1 (N.Y. Sup. Ct. March 9, 2009)

¹⁵ *Id.* at *1.

¹⁶ *Id.* at *2.

¹⁷ *Id.* at *2.

¹⁸ *Id.* at *3-4.

¹⁹ See *Federal Ins. Co. v. Kozlowski*, 792 N.Y.S.2d 397 (N.Y. App. Div. 2005).

or litigation guidelines can have the practical effect of diminishing the effectiveness of defense counsel and depriving the insured of the defense it is entitled to under the policy.

Policyholders should carefully analyze any billing guidelines the insurer sends and raise any concerns about compliance immediately. Specifically, a policyholder should not agree to guidelines that interfere with a lawyer's professional judgment, such as requiring prior approval before performing legal research or dictating how work is to be allocated among defense team members.

Numerous state bar opinions have stated that billing guidelines are improper. For example, the Supreme Court of Ohio's Board of Commissioners on Grievances and Discipline, in Opinion 2000-3 (June 2000), clearly stated that certain guidelines per se interfere with a lawyer's professional judgment and are therefore unethical for a lawyer to follow. These include guidelines that require prior approval before performing online legal research, dictate how work is to be allocated among defense team members, require approval before conducting discovery, taking depositions, or consulting with expert witnesses, and guidelines that require the insurer's approval before filing motions and pleadings.²⁰

The Rhode Island Supreme Court, in Ethics Advisory Panel Opinion No. 99-18 (October 1999), similarly held that a fact-specific determination was unnecessary with certain billing guidelines. The Panel stated that any guidelines that require the insurer's pre-approval for specified legal services such as conducting research, filing counterclaims and motions, visiting accident sites, and conducting depositions, among other activities, infringe upon the attorney-client relationship by "interfering with the independent professional judgment of defense counsel and ultimately with the quality of

legal services provided to the insured."²¹

In *Nortek, Inc. v. Liberty Mutual Ins. Co.*, the policyholder argued that the insurer failed to meet its defense obligation by not reimbursing the plaintiff for all necessary defense costs.²² The insurer had accepted its defense obligation subject to billing restrictions:

As set forth in Liberty Mutual's letter of November 14, 1990, the "defense" was made subject to restrictions unilaterally imposed by Liberty Mutual and not found in the Policy. The restrictions included a "cap" of \$105 per hour for attorneys fees, \$55 per hour for paralegal time, no reimbursement for secretarial overtime, no reimbursement for "meals or over night [sic] trial without pre-approval," and no reimbursement for any costs, expenses or attorneys' fees that were incurred before October 15, 1990.²³

The court held that the defendant breached its obligation to defend, in part, by its failure to reimburse the plaintiff policyholder for "all of the reasonable fees and expenses [it] incurred defending itself against all the claims[.]"²⁴

V. CONCLUSION

Government investigations can be very expensive. Insurance is an important asset to eliminate or defray the litigation costs. A policyholder faced with a governmental investigation should carefully review the "notice" and "claim" provisions of the relevant insurance policies immediately. State law varies on the many key insurance issues and therefore, the policyholder should also examine the applicable law to determine how to proceed. In short, while there are usually many things to worry about during a government investigation, whether your insurer will pay for defense costs should not be one of them.

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FOOTNOTES

²⁰ *Op.* at 1.

²³ *Id.* at 1234, n.3.

²¹ *Op.* at 1.

²⁴ *Id.* at 1238-39.

²² *Nortek, Inc. v. Liberty Mutual Ins. Co.*, 858 F.Supp. 1231 (D.R.I. 1994)

D&O/E&O Insurance Coverage Checklist

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It is essential for a corporation to review its insurance coverage to ensure that the company, including its Officers and Directors, are adequately covered in this environment of increased regulatory oversight and follow-on civil litigation. The following is a checklist of critical issues that can arise in typical securities class action and derivative lawsuits, and government investigations; and the milestones where sophisticated coverage counsel can assist to protect you and your company against the inadvertent and unnecessary loss of an important corporate asset: its insurance. In addition, companies may be able to recover their costs of internal investigations, if they follow the right procedures, ensure proper notice, and respond when insurers raise their inevitable coverage defenses.

- Is it a covered “**Claim**” under the Policy definitions?
 - Lawsuit/other demand for monetary or non-monetary relief?
 - Regulatory inquiry?
 - Administrative action?
 - Formal or informal investigation?
 - Administrative claim or notice?
 - Cease and desist demands?
 - Subpoenas, target letters, Wells notices, proffer agreements, or other demands?
 - Facts and circumstances that might constitute a claim?
- Does the lawsuit seek covered “**Loss**”?
 - Damages (Settlements or Judgments?)
 - Defense Costs , advanced as they are incurred, but beware of:
 - Special Litigation Committee defense costs (is there a dual purpose? Sublimated coverage?);
 - Fines and Penalties (can they be recharacterized?);
 - Disgorgement/Restitutionary loss?
- Do the allegations fall with the Policy definitions of “**Wrongful Acts**”?
- Have you provided **timely notice**?
 - Initial claim?
 - Amendments/Developments?
 - Prior Litigation issues?
 - Interrelated Act issues?
- Do you have the insurer’s **consent**?
 - Consent to counsel?
 - Panel counsel issues?
 - Do **Litigation Guidelines** invade an attorney’s ethical obligations?
 - Consent for expenditures/experts?
 - Have you kept the insurer aware?
- Do you have **allocation** problems?
 - Covered vs. uncovered claims or parties?
 - Co-pay provisions?
 - Self-insured retention (SIR) issues/? Credits due?
 - Insurers paying less than 100%.
- Do the policy’s **Severability** Provisions protect innocent Insureds?
 - Will knowledge be imputed to innocent insureds?
 - What knowledge is imputed?
- Are there problems re **Exclusions**?
 - Conduct or “dishonesty” exclusions such as fraud, criminal conduct/violations of law, compensation not Board approved (has there been a “final adjudication”?)
 - Professional services exclusions?
 - Insured vs. Insured issues?
 - Stock “Bump Up’/Inadequate purchase price allegations?
 - Prior Acts/Prior & Pending Litigation (relation back issues?)

- Are there **Rescission** threats, where the insurer might seek to unwind the policy based on alleged material misrepresentations or an intent to deceive?
 - In the Policy Application?
 - In Financial Statements that are submitted or publicly available?
 - What knowledge is imputed?

- Can you **settle** without problems?
 - *Prior* insurer written **consent** issues? (Courts may not allow *fait accompli*);
 - Does the insurer have sufficient factual support to justify opening its checkbook? Status reports?
 - “Voluntary payment” arguments?
 - Indemnifiable loss issues?
 - Partial vs. global settlements?
 - Demands for contribution from insureds?
 - Other issues raised in the insurer’s Reservations of Rights? Allocations?

- Do you have **excess policy** concerns?
 - Notice issues?
 - Underlying policy exhaustion/gap filling issues?
 - Maintenance of underlying insurance;
 - Depletion of limits issues?
 - Favored nation clauses?

- Inconsistent provisions, including **choice of law** and **arbitration provisions**?

- Are there **Bankruptcy** considerations?

- Do you have “**Side A Only**” issues?

- Can you benefit from a policy audit at time of renewal to ensure you have the best coverage for the dollars spent, to avoid problems when you need insurance the most?

Ranked as a top policyholder practice by Chambers USA, and recognized as a respected leader in the area, Howrey’s Insurance Recovery group consistently obtains impressive results on behalf of *Fortune* 500 and Global 500 companies. To date, through successful pre-litigation claims advocacy, litigation and trial, Howrey has recovered billions of dollars for our clients.

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THE FCPA CORNER – 2009 Trends and Update

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As we approach the end of the third quarter of 2009, the Department of Justice (“DOJ”) and the Securities and Exchange Commission (“SEC”) are making good on their 2008 promises to continue to increase enforcement of the Foreign Corrupt Practices Act (“FCPA”). This year already has seen penalties assessed (some of record-setting proportion) against both public and private corporations, and continued governmental pursuit of companies associated with the U.N. Oil-for-Food program.

In our first issue of *the Defender*, we highlighted the September 2008 statement of Mark Mendelsohn, the Deputy Chief of the Fraud Section of the DOJ, and the official responsible for FCPA prosecutions, who reported that the number of individual FCPA prosecutions has risen – and “that is not an accident. It is our view that to have a credible deterrent effect, people have to go to jail.”¹ This year the government already has tried four individual defendants in three cases of FCPA charges; all of which resulted in convictions. The four defendants are now awaiting sentencing, and will likely face substantial prison time. In addition, the government is on the eve of trial in at least one other FCPA case involving high profile executives.

As we consider the many FCPA-related events that have occurred in 2009, one thing is for sure, the new leadership at the DOJ (Attorney General Eric Holder) and the SEC (Chairperson Mary Shapiro), appointed by the Obama administration, have given every indication

that there will be no letting up on the recent trend of expanding the reach of FCPA investigations and prosecutions. Shapiro, less than one month after her Senate confirmation on January 22, 2009, said that “FCPA violations have been and will continue to be dealt with severely by the SEC and other law enforcement agencies.”² The government has followed through on this commitment, reporting on May 26, 2009, that it was investigating at least 120 companies regarding potential FCPA violations.³ Moreover, Robert Khuzami, Director of the SEC’s Division of Enforcement, recently announced plans to create a Specialized Unit dedicated to investigating FCPA violations as part of a broad reorganization of the Division.⁴

I. CORPORATE AGREEMENTS

The 2009 calendar began in the wake of late December DOJ and SEC announcements that Siemens AG and its subsidiaries had pleaded guilty to violating internal controls and books and records provisions of the FCPA.⁵ As it turned out, these record-setting settlements merely set the bar for the new administration to demonstrate its commitment to pursuing FCPA violations. And it didn’t take long for them to deliver.

On February 11, 2009, a mere 9 days after Eric Holder was confirmed by the Senate, the DOJ announced, largely based on work of the prior administration, that Kellogg Brown and Root LLC (“KBR”) had pleaded guilty to a five-count criminal information, with

FOOTNOTES

¹ See *Defender*, Volume I, “An Evolving Landscape,” citing American Bar Association Conference, “The Foreign Corrupt Practices Act: Current SEC and DOJ Enforcement Initiatives,” September 11, 2008, Washington, DC.

² February 11, 2009, press release, www.usdoj.gov.

³ Dionne Searcey, *U.S. Cracks Down on Corporate Bribes*, Wall Street Journal, May 26, 2009, <http://online.wsj.com/article/SB124329477230952689.html>

⁴ The full text of Khuzami’s speech can be found at <http://www.sec.gov/news/speech/2009/spch080509rk.htm>. For a more in-depth discussion of the reorganization of the Enforcement Division, see Fiona Philip and Peter Unger, *Howrey Client Alert: SEC Enforcement Division Announces New Policies and Procedures, Including Creation of Subgroups for Targeted Investigations*, August 7, 2009, <http://www.howrey.com/secs-division-of->

[enforcement-announces-new-policies-and-procedures-08-07-2009](http://www.howrey.com/secs-division-of-enforcement-announces-new-policies-and-procedures-08-07-2009).

⁵ Siemens reached settlements for record-setting dollars with the DOJ (\$450 million fine), and with the SEC (\$350 disgorgement of profits), with both settlements involving the appointment of a four-year compliance monitor. See December 16, 2008, <http://fcpublog.blogspot.com>. This four-year monitor departs from the normal government practice of imposing a three-year monitorship, likely because of the pervasiveness of the offending conduct.

one conspiracy count and four substantive counts of violating the FCPA.⁶ KBR agreed to pay the DOJ a \$402 million fine, second only to the Siemens fine. KBR admitted to paying Nigerian officials at least \$182 million in bribes for engineering, procurement and construction contracts to build liquefied natural gas facilities. The contracts to an international joint venture led by KBR were worth more than \$6 billion. KBR's parent company, KBR Inc., and its former parent company, Halliburton Co., also settled civil FCPA charges with the SEC, agreeing to be jointly liable for \$177 million in disgorgement of profits. The SEC's complaint alleged that internal controls had failed to detect or prevent the bribery, and that records were falsified to cover up the illegal payments. The SEC's final order also enjoined KBR and Halliburton from violating the anti-bribery and records falsification provisions in Sections 30A, 13(b)(5) and Rule 13b2-1 of the Securities Exchange Act of 1934; enjoined them from aiding and abetting violations of the record-keeping and internal control provisions in Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act; imposed an independent monitor for KBR for three years to review its FCPA compliance program; and imposed an independent consultant to review Halliburton's FCPA-related policies.⁷

After the KBR/Halliburton settlement, in February/March 2009 the corporate world breathed a small sigh of relief as there seemed to be a lull in the pace of FCPA announcements coming from the DOJ and SEC. For a moment, some companies probably dared to hope that the magnitude of the Siemens and KBR settlements had been an anomaly, representing a ceiling on the government FCPA enforcement trend. However, as we finish Q3 of 2009, the question of future record-setting penalties is still open for debate. No new penalties of this magnitude have come down after the KBR settlements, but the last six months have demonstrated that the lull in FCPA enforcement announcements during

February/March was most likely due to the transition process, as the new administration changeover reached the operational levels of governmental organizations. It is now clear that ongoing investigations did continue during this time, and in many cases, at an aggressive pace.

On April 7, 2009, the DOJ re-emerged in the FCPA arena with the announcement that Latin Node Inc., a privately held Florida corporation involved with providing wholesale telecommunications services using Internet protocol technology in a number of countries throughout the world, pleaded guilty to a "one-count information charging a criminal violation of the FCPA's anti-bribery provisions."⁸ As part of the agreement, Latin Node agreed to pay a \$2 million fine for admitting that it had made approximately \$1.1 million in payments to third parties with knowledge that some or all of the money was passed on to Honduran officials of the state-owned telecommunications company.⁹ This plea was largely fueled by a voluntary disclosure made by Latin Node's parent company, eLandia International Inc. eLandia cooperated with the DOJ and took appropriate remedial actions, including terminating senior Latin Node management with involvement or knowledge of the improper conduct.¹⁰

The Latin Node case is significant not because of the magnitude of the penalties assessed, but instead because of the example it provides of the positive effects of early corporate identification of FCPA violations, voluntary disclosure, and subsequent full cooperation with the government. On August 28, 2008, the DOJ circulated the "Principles of Federal Prosecution of Business Organizations," Memorandum from Mark R. Filip, Deputy Attorney General, to Heads of Department Components and United States Attorneys.¹¹ The "Filip Memorandum" described updated policies for charging of corporate entities, and alleged that there would be a realistic and tangible benefit to corporations that cooperated with government investigations.¹² In eLandia's case,

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FOOTNOTES

⁶ February 11, 2009, press release, www.usdoj.gov.

⁷ February 12, 2009, <http://fcpublog.blogspot.com>.

⁸ April 7, 2009, press release, www.usdoj.gov.

⁹ Id.

¹⁰ Id.

¹¹ Available at <http://www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf>.

¹² Id.

their significant cooperation, and “commendable efforts” cited by the government in its cooperation memorandum to the court, resulted in eLandia completely avoiding being charged in the case.¹³ The government accepted a plea to a single count from Latin Node, despite alleged evidence of \$1.15 million in other payments made by Latin Node with knowledge that some or all of this money would be passed on to officials in Yemen. Additionally, no organizational probation or compliance monitorship was required of either eLandia or Latin Node, and the criminal penalty was far below the U.S. sentencing guidelines range.¹⁴

Does this mean that the new administration is going soft on corporate penalties? Not by a long shot. Instead, the Latin Node case provides a good example that if a corporation is willing to be transparent and to bear the expense of significant cooperation, (likely including an appropriate internal investigation and production of a large volume of material to the government), that the reward can also be significant.¹⁵ What is certain is that other companies now are following the eLandia example, making early disclosures of FCPA violations in an effort to avoid stiff penalties. In some cases, such as in the recent disclosure announced by Sun Microsystems¹⁶, companies are self-reporting even earlier – in Sun’s case, at the first sign that a violation *may* have occurred.

The next corporation to reach an agreement to settle FCPA charges was Novo Nordisk, a Danish pharmaceutical corporation and a leading supplier of insulin. On May 11, 2009, Novo Nordisk, agreed to a deferred prosecution agreement with the DOJ that included the payment of a \$9 million penalty for one count of conspiracy to commit wire fraud and to violate the books and records provisions of the FCPA.¹⁷ According to the DOJ, “Novo paid approximately \$1.4 million to the former Iraqi government by inflating the price of contracts by 10 percent . . . and concealed from the United Nations

[UN] the fact that the price contained a kickback.”¹⁸ Novo also reached a settlement with the SEC and agreed to pay approximately \$3 million in civil penalties, \$4.3 million in disgorgement of profits, and \$1.3 million in pre-judgment interest.¹⁹ The agreement requires Novo and its subsidiaries to cooperate fully with the DOJ’s ongoing Oil-for-Food investigation which was started during the previous administration.²⁰ The Oil-for-Food program was established by the UN to allow Iraq to sell its oil for humanitarian purposes. However in 2000, the Iraqi government began requiring companies wishing to sell goods and services under this program to pay a kickback to the government.²¹ While there is nothing record-setting about these penalties, this case does demonstrate that the new administration remains committed to investigating FCPA violations in all corporate product and service areas, even those with the best of intentions. It also demonstrates that the DOJ Oil-for-Food investigation is alive and well under the Obama administration.

On July 28, 2009, the SEC filed a settled enforcement action in federal court against Avery-Dennison Corp. (“Avery”).²² On the same day, the SEC also instituted a settled administrative proceeding against the company.²³ According to the complaint, Avery’s Chinese subsidiary (“Avery China”) paid approximately \$30,000 to Chinese officials between 2002 and 2005, including cash kickbacks, gifts, sightseeing trips, and the retention of an official’s husband as a sales manager.²⁴ The SEC further claimed that Avery China attempted to make other improper payments, but was prevented from doing so by the parent company.²⁵ In addition to the violations at Avery China, employees at two companies acquired by Avery in 2005 and 2007 allegedly made hundreds of petty cash payments totaling \$51,000 to officials in Indonesia, Pakistan, and China.²⁶

All of the improper payments were discovered dur-

FOOTNOTES

¹³ April 21, 2009, <http://fcpublog.blogspot.com>.

¹⁴ *Id.*

¹⁵ For more information on the benefits of cooperation with FCPA investigations and prosecutions, contact FCPA-experienced outside counsel.

¹⁶ See May 13, 2009, <http://fcpublog.blogspot.com>.

¹⁷ May 11, 2009, www.usdoj.gov.

¹⁸ *Id.*

¹⁹ May 13, 2009, SEC Actions Blog; Thomas O. Gorman, Porter Wright, Washington, DC.

²⁰ *Id.*

²¹ May 11, 2009, www.usdoj.gov.

²² July 28, 2009, www.sec.gov.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

ing two successive internal investigations conducted by Avery and were promptly reported to the SEC.²⁷ Under the settlement agreement, Avery was required to pay a civil penalty of \$200,000. The company also agreed to pay more than \$315,000 in disgorgement and prejudgment interest.²⁸

The conduct charged by the SEC in this case lies at the opposite end of the spectrum from the actions of Siemens and KBR. Compared to the hundreds of millions of dollars in bribes alleged to have been paid by Siemens and KBR, the illicit payments attributed to Avery-Dennison—\$80,000 in actual payments over a period of eight years—can appear trivial. By bringing this case, the SEC indicated that even relatively minor violations will not escape enforcement. Just as the enforcing agencies will doggedly pursue those guilty of egregious violations, they will not ignore lesser infractions.

On July 30, 2009, Helmerich & Payne entered into a deferred prosecution agreement with the DOJ on FCPA grounds.²⁹ The company, which provides oil drilling rigs, equipment, and personnel on a contract basis, also reached an agreement to settle claims brought by the SEC.³⁰ The allegations related to payments made by Helmerich & Payne's Argentine and Venezuelan subsidiaries to customs officials in those countries.³¹ The subsidiaries allegedly made at least fifty improper payments totaling approximately \$185,000 in order to permit and expedite delivery of equipment and materials and to evade higher duties and taxes.³²

Helmerich & Payne discovered the violations in May 2008 when an employee disclosed during the course of an FCPA training program that certain payments to Argentine customs officials might have been illegal.³³ The training program was part of a broader effort by the company to enhance FCPA compliance.³⁴ When

Helmerich & Payne's general counsel learned of the employee's statements, the company retained outside counsel and a forensic accounting firm to conduct an internal investigation; the results of the investigation were later voluntarily disclosed to the authorities.³⁵ Noting Helmerich & Payne's cooperation and implementation of robust remedial measures, the DOJ entered into a deferred prosecution agreement with the company.³⁶ Under the terms of the agreement, Helmerich & Payne was required to pay a penalty of \$1 million. The company also consented to pay an additional \$320,644 in disgorgement and \$55,077.22 in prejudgment interest under its settlement agreement with the SEC.³⁷

The DOJ's resolution of FCPA charges against Helmerich & Payne through a deferred prosecution agreement is reminiscent of the favorable agreement reached by Latin Node a few months earlier. As in the Latin Node case, Helmerich & Payne was not required to retain a corporate compliance monitor or ordered to serve a term of organizational probation.³⁸ Both cases demonstrate that voluntary disclosure, full cooperation, and sincere efforts to ensure compliance going forward can yield significant benefits for a company that violated the FCPA.

II. INDIVIDUAL PROSECUTIONS

Every corporation is built by individuals, and corporate ethics usually are driven by two primary motivators – a human desire to do what is right; and, somewhat more germane to this article, a desire to stay out of jail. As the DOJ and SEC have said repeatedly over the last several years in references to FCPA prosecutions, “in order to have a credible deterrent effect – people have to go to jail.”³⁹ The new administration has assumed this mantra,⁴⁰ and we have seen the trend of individual

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[Continued on page 12]

FOOTNOTES

²⁷ *Id.*

²⁸ *Id.*

²⁹ July 30, 2009, www.usdoj.gov.

³⁰ July 30, 2009, www.sec.gov.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ July 30, 2009, www.usdoj.gov.

³⁷ July 30, 2009, www.sec.gov.

³⁸ July 30, 2009, www.usdoj.gov.

³⁹ See e.g. See Defender, Volume I, “An Evolving Landscape,” citing American Bar Association Conference, “The Foreign Corrupt Practices Act: Current

SEC and DOJ Enforcement Initiatives,” September 11, 2008, Washington, DC.

⁴⁰ See e.g. February 11, 2009, press release, www.usdoj.gov. (Shapiro comments regarding FCPA enforcement).

In a recent case, the SEC advanced a novel legal theory that, though untested by judicial review, would support a broad expansion of liability for corporate executives.

indictments for FCPA violations continue through the third quarter of 2009. Interestingly, in several recent and pending DOJ prosecutions, the indicted individuals are choosing to put the government to its proof, making for complex and challenging FCPA trials for the DOJ. Three FCPA-related trials have already occurred this summer, and other trials appear to be on the horizon. However, these trials also demonstrate the great risk faced by indicted corporate individuals, as the defendants were held guilty in all three cases. Each FCPA violation carries a maximum penalty of five years in prison and a fine of the greater of \$100,000 or twice the value gained or lost.⁴¹ For its part, the SEC has continued to hold executives accountable for their role in corporate FCPA violations. In a recent case, the SEC advanced a novel legal theory that, though untested by judicial review, would support a broad expansion of liability for corporate executives.

Recent DOJ Prosecutions and Settlements

On April 8, 2009, the DOJ announced that six former executives of Control Components Inc., a California-based valve company were charged in a nine-year conspiracy to win contracts by bribing officials at foreign state-owned companies in violation of the FCPA.⁴² The indictment alleged bribery "in over thirty countries" totaling approximately \$6.85 million in cash payments, overseas holidays, vacations, and gifts that "resulted in net profits of approximately \$46.5 million."⁴³ Two other former executives pleaded guilty to conspiring to bribe officers and employees of foreign state-owned companies

in violation of the FCPA on January 8, 2009.⁴⁴

Currently four of the defendants are challenging the indictment.⁴⁵ Their trial, initially set for June 2, 2009 was rescheduled for December 8, 2009 after the defendants challenged the discovery produced by the government to support the indictment.⁴⁶ Although the prosecutors turned over at least 33,000 pages of documents, the defendants argued that these documents buried the allegedly illegal payments in a haystack of legitimate payments, making it impossible for them to mount a defense to the indictment. On April 22, 2009, the defendants filed a motion seeking to force the government to identify each of the payments, gifts, and travel expenditures alleged in the indictment.⁴⁷ The court granted the defendants' motion in part, ordering the government to specify the date, amount, and beneficiary of each of the 236 allegedly improper payments.⁴⁸ However, the court did not require the government to provide any further information as to gifts and travel expenses because the government had previously identified the relevant documents with sufficient particularity.⁴⁹

On June 2, 2009, the trial of Frederic Bourke on FCPA and other grounds began in the Southern District of New York.⁵⁰ Bourke, the owner of the luxury handbag brand, Dooney and Bourke, was indicted with Victor Kozeny for bribing government officials in Azerbaijan in a failed attempt to take over the state oil company known as Socar.⁵¹ At trial, Bourke's lawyers argued that Kozeny was the sole architect of the bribery scheme, and although Bourke had invested \$9 million with Kozeny,

FOOTNOTES

⁴¹ 15 U.S.C. §§78dd-3(e)2 & 78ff(c)3.

⁴² April 8, 2009, press release, www.usdoj.gov.

⁴³ May 14, 2009, <http://fcpablog.blogspot.com>.

⁴⁴ April 8, 2009, press release, www.usdoj.gov. Sentencing for these defendants is set for January 25, 2010.

⁴⁵ See Order Continuing Interim Status Conference, U.S. v. Carson, Case No. SA CR 09-00077-JVS (C.D. Cal. July 27, 2009).

⁴⁶ Findings and Order Regarding Continuance of Trial Date and Excludable Time Period, U.S. v. Carson, Case No. SA CR 09-00077-JVS (C.D. Cal. May 18, 2009).

⁴⁷ Defendants' Joint Motion for Bill of Particulars, U.S. v. Carson, Case No. SA CR 09-00077-JVS (C.D. Cal. May 18, 2009).

⁴⁸ Criminal Minutes – General, U.S. v. Carson, Case No. SA CR 09-00077-JVS (C.D. Cal. May 18, 2009).

⁴⁹ *Id.*

⁵⁰ David Glovin, *Bourke Tape Will Play Central Role in Bribery Trial*, Bloomberg.com, June 2, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aFMdDiTOiWjs>.

⁵¹ For general explanation of the Bourke case, see Defender Volume I, "An Evolving Landscape."

he was unaware of Kozeny's plans to bribe Azeri officials.⁵² The prosecution countered that the evidence demonstrated that Bourke was fully aware of Kozeny's intentions.⁵³ Further, based on everything Bourke had seen and heard, he must have suspected that Kozeny was making payments to Azeri officials.⁵⁴ On July 30, 2009, the jury convicted Bourke of conspiracy to violate the FCPA, among other charges.⁵⁵ Bourke's sentence, which will be determined on October 13, 2009, could include a prison term of up to five years.⁵⁶

The Bourke case—the first under the FCPA to reach trial since 2004—demonstrates that the DOJ is not afraid

While Bourke's trial was the first under the FCPA in five years, only weeks passed between the first day of Bourke's trial and the start of a second FCPA-related trial. On June 16, 2009, former Louisiana Congressman William Jefferson went on trial for solicitation of bribes, violations of the FCPA, and obstruction of justice.⁵⁸ Jefferson allegedly ran afoul of the FCPA by offering to pay a cash bribe of \$100,000 to a high level Nigerian official.⁵⁹ In exchange for the bribe, the official was to induce a government-controlled telecommunications company to provide the use of telephone lines and other facilities to a Nigerian joint venture controlled

**The Bourke case—the first under the FCPA to reach trial since 2004—
demonstrates that the DOJ is not afraid to pursue FCPA cases to trial and
has the resources to do so successfully.**

to pursue FCPA cases to trial and has the resources to do so successfully. The case is also instructive as to the degree of culpability required under the FCPA. Following 15 USC § 78dd-2(h)(3)(B), Judge Scheindlin instructed the jury that FCPA liability will attach to one who is aware of a high probability that a violation has occurred and “consciously and intentionally avoids confirming that fact.”⁵⁷ Therefore, Bourke would be guilty if he suspected that Kozeny was making improper payments and he deliberately prevented himself from learning the truth. This point was crucial in the case at hand because the DOJ's claim that Bourke had actual knowledge of the bribery scheme was hotly disputed.

by Jefferson's family members.⁶⁰ Jefferson promised to give the Nigerian official a share of the joint venture's profits in addition to the cash bribe.⁶¹

The most memorable aspect of the case related to a suitcase full of cash that Jefferson allegedly planned to give to the Nigerian official.⁶² On July 30, 2005, Jefferson received \$100,000 in marked bills from Lori Mody, a co-conspirator who was cooperating with the DOJ. Jefferson assured Mody that he would deliver the money to the Nigerian official.⁶³ However, the FBI conducted a raid of Jefferson's home in Washington shortly thereafter and found \$90,000 hidden in Jefferson's freezer.⁶⁴ The money was separated into \$10,000 incre-

[Continued on page 14]

FOOTNOTES

⁵² David Glovin, *Bourke Lawyers Seek to Portray Investor as Removed From Kozeny*, Bloomberg.com, June 17, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aDJl3K9LuOGQ>.

⁵³ David Glovin, *Bourke 'Stuck Head in Sand' on Azeri Oil Bribes, U.S. Says*, Bloomberg.com, July 7, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ao8zM4x8juP4>.

⁵⁴ *Id.*

⁵⁵ July 10, 2009, www.usdoj.gov.

⁵⁶ *Id.*

⁵⁷ July 20, 2009, <http://fcpcbog.blogspot.com>.

⁵⁸ Dionne Searcey, *Jefferson's Federal Bribery Trial Opens*, Wall Street Journal, June 17, 2009, <http://online.wsj.com/article/SB124516306826819081.html>.

⁵⁹ June 4, 2007, www.usdoj.gov.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² William Jefferson Gets Briefcase of Cash in Surveillance Video, The Times-Picayune, August 5, 2009, http://www.nola.com/news/index.ssf/2009/08/william_jefferson_gets_briefca.html.

⁶³ *Id.*

⁶⁴ *Id.*

ments and wrapped in foil.⁶⁵

On August 5, 2009, Jefferson was convicted on 11 of the 16 counts alleged in the indictment, but was acquitted on the charge of violating the FCPA.⁶⁶ Although Jefferson was not convicted of an FCPA violation, his case demonstrates that the DOJ remains steadfastly committed to bringing FCPA violators to justice. The DOJ showed that it will proceed to trial on FCPA grounds in appropriate cases even when key facts are in dispute and there is no guarantee of a conviction.

Six days before the Jefferson verdict was handed down, the DOJ continued the trend of individual prosecutions under the FCPA, this time against a foreign national. An indictment charging Ousama Naaman, a Canadian citizen, with FCPA violations was unsealed on July 30, 2009, after Naaman was arrested in Frankfurt, Germany.⁶⁷ Naaman, who had been indicted in August 2008, was charged with paying a series of kickbacks to the former Iraqi government between 2001 and 2003.⁶⁸ Naaman allegedly made the payments on behalf of a large U.S. chemical company, for which he served as an agent.⁶⁹ In exchange for the kickbacks, Naaman obtained five contracts for the chemical company under the UN Oil-for-Food program.⁷⁰ Additionally, in 2006, Naaman allegedly paid bribes totaling \$155,000 on behalf of the chemical company to officials in the Iraqi Ministry of Oil.⁷¹ The purpose of the bribes was to cause a product manufactured by the chemical company's competitor to fail a field test.⁷² The DOJ is currently seeking to extradite Naaman to the United States.⁷³ If extradited and convicted, Naaman would face a maximum sentence of fifteen years in prison.⁷⁴

On August 26, 2009, just three weeks after Jefferson was convicted, the third FCPA trial of the summer began.⁷⁵ The trial involved charges against Gerald and Patricia Green, who worked as movie producers.⁷⁶ According to a superseding indictment issued on March 11, 2009, the Greens were alleged to have paid at least \$1.8 million in bribes to the senior official of the Tourism Authority of Thailand (TAT) and to the official's friend and daughter.⁷⁷ The Greens allegedly paid the bribes in order to obtain contracts worth more than \$14 million from the TAT and agencies under the TAT's control, including several lucrative contracts relating to the annual staging of the Bangkok International Film Festival.⁷⁸ The Greens also won a contract from a government entity controlled by the TAT to assist with the introduction of an elite "privilege card" for foreigners in Thailand.⁷⁹ On September 11, 2009, a jury convicted the Greens of violating the FCPA after only a few hours of deliberations.⁸⁰ The Greens will be sentenced on December 17, 2009, and they face a minimum sentence of ten years in prison.⁸¹

While the DOJ cannot control the decisions of FCPA defendants either to plead guilty or to proceed to trial, the trials of Gerald and Patricia Green, William Jefferson, and Frederic Bourke do reflect the DOJ's renewed emphasis on FCPA enforcement. First, as a result of the recent dramatic increase in the number of enforcement actions brought under the FCPA, the pool of FCPA defendants is obviously larger and the likelihood that some defendants will choose to proceed to trial is greater. Further, the DOJ's decision to target individuals for FCPA violations is also partly responsible for the uptick in FCPA

FOOTNOTES

⁶⁵ *Id.*

⁶⁶ The jury did convict Jefferson on the conspiracy count, which reads, "Conspiracy to Solicit Bribes by a Public Official, Deprive Citizens of Honest Services by Wire Fraud, and Violate the Foreign Corrupt Practices Act." However, the verdict on this count is ambiguous because the jury could have convicted Jefferson even if he had conspired only to commit the non-FCPA crimes. See Jonathan Tilove, *William Jefferson Case will Always be Remembered for Cash in*

the Freezer, The Times-Picayune, August 5, 2009, http://www.nola.com/news/index.ssf/2009/08/william_jefferson_case_will_al_1.html.

⁶⁷ July 31, 2009, www.usdoj.gov.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ Greg Risling, *U.S. Trial in Thai Film Festival Bribery Case Begins*, AOL

Money & Finance, August 26, 2009, <http://money.aol.com/article/us-trial-in-thai-film-festival-bribery/624086>.

⁷⁶ September 14, 2009, www.usdoj.gov.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ September 15, 2009, <http://fcpublog.blogspot.com>.

⁸¹ *Id.* September 14, 2009, www.usdoj.gov.

trials. Individuals are more likely to take FCPA cases to trial because their greatest concerns are to demonstrate their innocence and retain their liberty. By contrast, corporations have powerful incentives to settle FCPA allegations so as to forestall government investigations, which can have damaging effects on efficiency, morale, and stock prices. One thing to note is that with increased individual prosecutions, the government must be prepared for the added expense and resources needed to litigate individuals in the courtroom and in the media. Whether these increased challenges deter the number or breadth of individual indictments for the government over the course of time still remains to be seen.

Other recent DOJ investigations have not resulted in indictments, largely because of the lack of resistance by the involved individuals. For example, on April 27, 2009 and May 18, 2009, Juan Diaz and Antonio Perez respectively pleaded guilty to one-count criminal informations for paying approximately \$1.7 million in total bribes to employees of Telecommunications d'Haiti (Haiti's state-owned telephone company) in return for better rates for Miami-based communications companies.⁸² Diaz and Perez admitted they conspired to make "side payments" through a shell company belonging to Diaz.⁸³ In another example, KBR's former CEO, Albert "Jack" Stanley, who pleaded guilty in September 2008 to conspiring to violate the FCPA, is cooperating actively with the government in hopes of a lighter sentence. As a result, his sentencing has already been rescheduled three times this year.⁸⁴

More recently, on September 3, 2009, Leo Winston Smith agreed to plead guilty to charges of conspiracy to violate the FCPA. Smith, who formerly served as director of sales and marketing for Pacific Consolidated Industries LP (PCI), was allegedly part of a conspiracy to make improper payments to the relative of an official in the

UK Ministry of Defence in order to obtain government contracts for PCI. According to the indictment, between 1999 and 2002, Smith and his co-conspirators paid a total of \$71,350 to the official's relative under a sham marketing agreement created by Smith. In 2003, a group of investors acquired PCI and brought the violations to the attention of the Department of Justice. PCI cooperated in the DOJ's ensuing investigation, which resulted in the prosecution of Smith individually.

The Smith case should serve as a cautionary tale to corporate executives who think that they will be able to cover up evidence of improper payments and evade prosecution. Like PCI, most corporations are all too eager to cooperate with the government in order to mitigate the legal consequences of FCPA violations. Typically, management will give the enforcing agencies full access to relevant records and witnesses, and will often commission an internal investigation at the company's expense. For this reason, it is highly unlikely that any substantial payment to government officials will escape detection.

SEC Creativity in Recent Enforcement Actions

On July 31, 2009, the SEC brought an FCPA claim under a legal theory that, if valid, would significantly broaden the scope of FCPA liability for corporate executives. On that day, the SEC filed a settled enforcement action against Nature's Sunshine Products, Inc., as well as Doug Faggioli and Craig Huff, the company's CEO and CFO.⁸⁵ The SEC's complaint alleged that the Brazilian subsidiary of Nature's Sunshine made payments totaling \$1 million in order to secure permission to import products into Brazil.⁸⁶ All parties settled with the SEC; Faggioli and Huff each agreed to pay a civil penalty of \$25,000, and Nature's Sunshine agreed to pay a penalty of \$600,000.⁸⁷

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The Smith case should serve as a cautionary tale to corporate executives who think that they will be able to cover up evidence of improper payments and evade prosecution.

FOOTNOTES

⁸² May 18, 2009, <http://fcpublog.blogspot.com>.

⁸³ *Id.*

⁸⁴ His sentencing is scheduled

for October 28, 2009. Notice of Setting, United States v. Stanley, No. 4:08-cr-00597 (S.D. Tex. July 8, 2009).

⁸⁵ July 31, 2009, www.sec.gov.

⁸⁶ *Id.*

⁸⁷ *Id.*

The first nine months of 2009 have seen both the SEC and the DOJ maintain and increase the intensity of FCPA enforcement, highlighted by record-setting penalties against corporations and three trials resulting in convictions against individual violators.

While the SEC's claim against Nature's Sunshine was fairly straightforward, its assertion of FCPA liability against the individual defendants rested on a novel legal theory that has yet to be litigated. Rather than claiming that Faggioli and Huff had personal knowledge of, or committed any violation of the FCPA, the complaint alleged under Section 20(a) of the Securities Exchange Act of 1934 that the two men failed to prevent other employees under their control from violating the law.⁸⁸ Under Section 20(a), an individual can be held liable for violations committed by persons under his "control." Thereby, the SEC contended that Faggioli and Huff were responsible for the unlawful conduct of subordinate employees even though they had no role in or knowledge of the violations.

The SEC's claim of "control person" liability against Faggioli and Huff under Section 20(a) is the first time that the SEC has used this legal theory to encompass violations of the FCPA. Although not tested through any judicial ruling, this new theory of recovery significantly expands the scope of potential enforcement actions against individuals and makes the SEC a more prominent player in governmental enforcement of FCPA violations. Assuming that the theory is upheld when tested by judicial review, the use of Section 20(a) gives the SEC more flexibility to pursue individuals based on their corporate position. In contrast, the Department of Justice ("DOJ") is often hindered in prosecuting FCPA violations against an individual by the necessity of showing that the individual had knowledge of, or participated in improper activity under the FCPA.

One month later, on August 31, 2009, the SEC filed a settled enforcement action against Oscar Meza, who formerly served as Director of Asia Pacific Sales for Faro Technologies, Inc. ("Faro").⁸⁹ Faro had previously agreed to settle allegations that its Chinese subsidiary ("Faro China") had made improper payments to em-

ployees of state-owned companies in order to secure lucrative contracts.⁹⁰ The SEC alleged in its complaint against Meza that Meza explicitly authorized employees at Faro China to make the payments.⁹¹ From 2004 until early 2006, Meza allegedly persisted in approving bribe payments despite receiving repeated warnings from his superiors that the practice was illegal.⁹² In order to settle the SEC's allegations, Meza agreed to pay more than \$55,000 in penalties, disgorgement, and prejudgment interest.⁹³

III. CONCLUSION

The first nine months of 2009 have seen both the SEC and the DOJ maintain and increase the intensity of FCPA enforcement, highlighted by record-setting penalties against corporations and three trials resulting in convictions against individual violators. The enforcing agencies appear determined to send a strong message to the international business community, and have concluded that the best way to do so is through strict accountability. Both the SEC and DOJ have upped the ante in prosecuting individuals: the DOJ has increasingly sought to send individual violators to prison, while the SEC has attempted to expand the scope of FCPA liability using at least one innovative legal theory. At present, it remains to be seen whether the government will remain committed in the long term to robust enforcement against individuals due to the extremely high cost of pursuing these cases to trial. One thing is for certain – the DOJ and SEC will continue aggressively reviewing potential violations of the FCPA for the foreseeable future. If you have questions, or are unsure of the status of your company's compliance with the FCPA – seek advice. As 2009 has shown, advanced detection and management of potential violations leads to deferred prosecutions and significantly reduced penalties.

FOOTNOTES

⁸⁸ *Id.*

⁸⁹ August 31, 2009, www.sec.gov.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

Quick Guide to Federal Search Warrants and Grand Jury Subpoenas

By Mary Carter Andrues

Federal search warrants and grand jury subpoenas are standard law enforcement tools used in most federal investigations. It is important to be prepared in advance so that you can quickly, effectively, and appropriately respond to the government's investigation in the event a search warrant is executed at your business premises or a grand jury subpoena is served. Set forth below is a quick guide which can be used as a primer for implementing a protocol for responding to a search warrant or subpoena.

I. FEDERAL SEARCH WARRANTS

The Law

A federal search warrant is issued by a district or magistrate court judge, within the district where the items to be seized are located. The standard for issuing a search warrant is "probable cause" – that is probable cause to believe that specific crimes have been committed and evidence of such crimes is located on the premises to be searched. The warrant also must state with particularity the place to be searched and the items to be seized. The warrant is based on the written sworn affidavit of a federal law enforcement officer, which often is filed under seal. In the Central District of California, search warrants and affidavits are reviewed and approved by the U.S. Attorney's Office for this district, even if the warrant is based on an out of district investigation.

The warrant must be executed within 10 days of issuance, and unless a nighttime search is authorized, it must be executed during the day, between 6:00 a.m. to 10:00 p.m. Under Federal Rule of Criminal Procedure 41(f)(1)(C), the agents must provide a copy of the warrant. If the affidavit is not under seal, the affidavit in support of the warrant should accompany and be incorporated into the warrant. Under Federal Rule of Criminal Procedure 41(f)(1)(B) and 41(f)(1)(C), the agent should provide a list or inventory of the items seized. The agents are required to "return" the warrant to the judge who issued the warrant, with a copy of the inventory.

What to Expect When Being Searched

Numerous armed federal law enforcement agents will arrive at the premises, usually in the morning. If the premises are closed at the time set for the search, the agents may contact someone from the target company to open the premises. The agents are permitted to break into the premises if refused entry or no one is available to provide access. In most instances the premises initially will be secured once the agents make entry. That means all employees will be asked to move away from desks and work stations, sometimes the employees will be asked to gather in a common area, such as a lobby or lunch room, other times the employees will be instructed to leave the premises.

The agents will sweep the premises to ensure that there are no safety hazards prior to searching and forensic computer agents will secure all computers so that no data is destroyed or corrupted. Many times, the agents will photograph or film the premises at the start and end of the search. One or more agents will diagram the premises, noting offices and to whom the offices are assigned, storage areas, computer facilities etc. Many times the diagrams will include labels for desks and file cabinets within specific areas from where records were seized.

If the agents anticipate finding attorney-client privileged documents, there may be one or more agents designated to handle the privileged documents. If the agents anticipate seizing classified documents, there usually will be agents with the necessary security clearance and representatives from the classifying agency on site to handle this material. Also, with the court's permission, the technical experts can accompany the agents if specific expertise is needed during execution of the warrant. Sometimes, the search also will involve local and state law enforcement agents.

Once entry is made and the premises are secured, the agents will begin to search for the items to be seized. Many times, the agents will attempt to interview employees to obtain additional information useful to the



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investigation, including the existence and location of additional storage facilities. In addition, if the agents locate items outside the scope of the warrant, it is common to ask for consent to search those premises and seize any such items. The agents also may seek what generically is referred to as a “roll-back” warrant from the court to seek documents outside the scope of the original warrant.

Generally, there will be an Assistant United States Attorney (“AUSA”) assigned to the case or on duty at the United States Attorney’s Office who is available by phone to answer questions from the agents or the target of the search warrant. On rare occasions, the AUSA may accompany the agents on the search. There also is a designated case agent who coordinates the search, maintains contact with the AUSA during the search, and is responsible for clearing the premises at the end of the search.

Search Warrant Protocol

No one wants to receive a telephone call at 6:00 a.m. advising them that a swarm of armed federal agents are standing at the door of their business premises with a search warrant in hand. Nonetheless, it is important to establish a clear protocol that will be followed by management and all employees in the unlikely event that your business is the target of a search warrant. Set forth below are some of the elements that should be included in the protocol:

- Establish a contact person or response team, with 24 hour contact information, who will be immediately contacted, including outside counsel with experience in handling criminal cases. The contact list also should include a designated person to handle media contact.
- Procedures should be established for closing the premises during the execution of the warrant, including discharging employees for the day. The agents are permitted to temporarily detain and search employees leaving the premises to ensure that none of the items to be seized are being secreted out of the premises. The agents can search briefcases, purses and other personal items for the same reason.
- Note, a search warrant does not require the employees to make any statement to the agents or submit to an

interview. The protocol should include procedures to advise the employees that the warrant does not give the agents the right to conduct interviews and employees are not required to speak with the agents. If an employee chooses to speak with the agents, ask the agents to wait until outside counsel is present. If the agents refuse, contact outside counsel immediately to handle the situation, including contacting the AUSA regarding any further contact by the agents with the employees.

- Do not give consent to search any area or seize any documents. No one is required to provide consent to search the premises or seize items beyond the scope of the warrant; and no one is required to direct the agents to the location of the items to be seized. However, there may be times in which it is in the company’s best interest to provide limited information to the agents to facilitate the search.
- Obtain a copy of the search warrant and ask for a copy of the affidavit. If the agent refuses to provide the warrant, politely remind the agent that Federal Rule of Criminal Procedure 41(f)(1)(C) requires the agent to provide a copy of the warrant. If the affidavit is under seal, the agent is not required to provide you with a copy of the affidavit.
- Ask all agents to show identification, BUT DO NOT interfere with federal agents during the execution of the search warrant. Count the number of agents on site, request business cards, and try to determine for which agencies the agents work.
- Ask the case agent to wait until in-house or outside counsel arrive before executing the search warrant. Note, this is highly unlikely, but worth a try.
- Without interfering with the search, have members of the response team accompany the agents during the search. Prepare a detailed log of the locations searched, the documents and records seized, if possible, and statements made by the agents during the execution of the warrant.
- If the search exceeds the scope of the warrant, state your objection to the search or seizure, and make a written record of the objection, e.g., to whom the objection was made, and the time and location of the objection. Note: classified documents are not exempt from search and seizure. If classified documents are being searched

[I]t is important to establish a clear protocol that will be followed by management and all employees in the unlikely event that your business is the target of a search warrant.

and/or seized, advise the case agent of the classified nature of the documents and request that only those agents with the appropriate level of clearances should have access to the documents. Advise the AUSA of the search and seizure of the classified material and notify the classifying agency of the seizure.

- Request a copy of the search inventory and a receipt for the seized evidence at the end of the search, BUT do not sign anything.
- Do not destroy any documents or records during or after the search, as it could give rise to obstruction of justice charges.

II. FEDERAL GRAND JURY SUBPOENAS

The receipt of a federal grand jury subpoena is a sign that a government investigation is underway, but it does not necessarily mean that your company is the target of the investigation. The target of the investigation may

have the right to refuse to be interviewed and have an attorney present if they decide to participate in an interview. In addition, do not destroy any documents once the subpoena is served and suspend any standard document retention/destruction policies.

Preparing a protocol for responding to a grand jury subpoena is a good business practice. The subpoena will require a review of hard and electronically stored documents. Someone who can act as a custodian and testify in front of the grand jury should be designated to coordinate gathering the documents within the company. It is highly advisable to have outside counsel review the documents for responsiveness and privilege prior to production.

The custodian should maintain a log of where the documents were located within the company. The documents also should be copied and Bates numbered prior to the production. Generally, the AUSA will ac-

Like search warrants, the subpoena does not permit the agent to interview any employees. All employees have the right to refuse to be interviewed and have an attorney present if they decide to participate in an interview.

be another company and the government is seeking information about your company's relationship with that company, or documents in your company's possession that may be relevant to the investigation.

A federal grand jury subpoena is prepared by an AUSA. The subpoena may be prepared at the request of a federal agent or on the AUSA's initiative as part of an investigation. The subpoena may request documents, the testimony of a witness before the grand jury, or both. The subpoena generally is served by a federal law enforcement agent on the custodian of records; and will specify the documents and records to be produced, the relevant time period, and the date for the production. Often the scope of the documents requested is quite broad, however, AUSAs generally will agree to a rolling production and may narrow the scope of the documents with some negotiation by counsel.

Like search warrants, the subpoena does not permit the agent to interview any employees. All employees

cept copies with an agreement that the originals will be maintained and made available upon request. A privilege log should be prepared, and provided to the AUSA upon request, for all documents withheld from the production on the grounds of attorney-client privilege or attorney work product.

III. CONCLUSION

Clearly, no company wants to be the target of a federal criminal investigation. However, in this era of aggressive federal prosecution and the increased "criminalization" of government regulations, it is important to be prepared. Developing protocols for handling search warrants and grand jury subpoenas can help minimize disruptions to business operations, contain unfavourable media coverage, and provide for a means to quickly begin communicating with government prosecutors to limit the scope of the investigation and minimize the company's exposure.

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