White-Collar Defense

EXECUTIVE SUMMARY

Following nearly a decade of focus on post-9/11 terrorism cases, financial fraud is receiving renewed scrutiny from federal authorities. Resources are increasingly directed toward the investigation and prosecution of white-collar crimes, particularly in relation to international commerce through the Foreign Corrupt Practices Act (FCPA) (15 USC 78dd-1-78f). A report by the Paris-based Organisation for Economic Co-operation and Development (OECD) noted that U.S. FCPA prosecutions have quadrupled since 2005, resulting in more than $1 billion in foreign bribery proceeds in the past six years. Furthermore, the U.S. Securities and Exchange Commission (SEC) has become increasingly active in FCPA cases, opening an office in San Francisco in 2010 specifically dedicated to these matters.

Our panel of experts discusses these topics, as well as issues related to the whistleblower bounty provisions to the Dodd-Frank Wall Street Reform and Consumer Protection Act, and trends related to international tax enforcement and the honest services statute. They are Steve Mansfied of Akin Gump Strauss Hauer & Feld; Nathan Hochman and Raymond C. Marshall of Bingham McCutchen; Ken Miller of Bienert, Miller & Katzman; McGregor "Greg" Scott of Orrick, Herrington and Sutcliffe; and Kristin D. Rivera of Pricewaterhouse Coopers. The roundtable was moderated by *California Lawyer* and reported by Krishanna DeRita of Barkley Court Reporters.

MODERATOR: What trends do you see in fraud investigations and prosecutions?

RIVERA: As a forensic accountant, I noticed that during the economic downturn, many companies seemed to rely more on in-house investigative resources, presumably as a cost-cutting measure. With the economy rebounding, this trend has begun to reverse. However, instead of going back to hiring a team of external lawyers and accountants they've never worked with before, companies seem to be using a combination of in-house and external resources to conduct investigations.

MARSHALL: At Bingham, we've developed a litigation tech support group as a cost-saving measure for our clients so that we don't have to rely as heavily on outside vendors to assist in document review and production. Certain smaller and mid-sized matters we handle on our own, which is, in part, a result of increased pressure from clients for cost control. But when faced with defending a complex criminal or white-collar case, particularly one that could appear in the press, the cost of defense is important, but it's rarely the driving issue for clients.

HOCHMAN: There have been three intersecting trends that have produced significant growth in white-collar investigations and prosecutions. The first involves the redeployment of law enforcement resources. The Federal Bureau of Investigations (FBI) has historically been on the frontline of white-collar fraud investigations. But post-9/11, there was a wholesale reallocation of the FBI's resources from fraud cases to tracking down leads in terrorism cases. In the last several years, those resources have begun to be redeployed toward white-collar cases. They are hiring more people, and cases that either stalled or were never made are now going full bore.

The second trend relates to the economic downturn over the past several years. As with downturns in past decades, crimes that might not otherwise have been unmasked in a good economy—like securities and mortgage fraud and Ponzi schemes—become more visible in a bad economy.

The third trend concerns the public's outcry for more law enforcement. When times are good, there is less of a public demand for more prosecutions and harsher punishment. As people lose their retirement savings from stock manipulation, their houses from mortgage fraud, and their jobs from corporate malfeasance, there is a greater public demand for accountability and punishment. These trends should result in an increase in white-collar criminal investigations and prosecutions for years to come.

SCOTT: That's right. For the first time since 9/11, new FBI white-collar fraud slots have been created and agents have been allocated to the field offices. At the same time, multiple new assistant U.S. Attorney (AUSA) positions dedicated to mortgage fraud have been created. For the first time since 9/11, there's a white-collar focus again in terms of DOJ's allocation of resources, and that's a trend that's going to expand beyond mortgage fraud to health care fraud.

MANSFIELD: The U.S. Department of Justice (DOJ) is now deploying senior prosecutors in local U.S. Attorneys' offices to better target, in a regional way, the Fraud Section resources throughout the country. There's a tremendous push to move on many large-scale fraud cases, and the Fraud Section wants to be a significant player. There will be many cases brought over the next three to five years, and some interesting competition with U.S. Attorneys' offices over who handles particular cases.

On the SEC front, we've seen the agency adopt policies that are similar to how federal prosecutors investigate crimes, initiate settlement discussions, and seek and use cooperation to build cases. This will enable that agency to move expeditiously in making cases.

MARSHALL: We also have a new U.S. Attorney in San Francisco, and a new California Attorney General who has announced that among her priorities are the enforcement of mortgage fraud and environmental crime cases. There are parallels between the Obama administration's focus on enforcement and what's going to happen at the state and regional levels with respect to an emphasis on financial fraud and program fraud, and on state and local law enforcement working collaboratively.

RIVERA: I've noticed that the SEC seems to be taking a

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more active role in driving investigations. Increasingly, they suggest procedures and encourage outside investigators to dig deeper into particular issues. The SEC has been more proactive in seeking firm conclusions from the outside investigators before they sign off on an issue.

MILLER: In the past, there have been large corporate settlements or deferred prosecution agreements (DPAs) in FCPA cases recently, as well as huge corporate settlements in the off-label promotion of pharmaceuticals. This has fueled the perception that corporations are treating large settlements as simply a cost of doing business. So now the DOJ is making a concerted effort to go after individuals in the belief that it is a better deterrent.

Because its relatively easy for the DOJ to go after corporations due to "respondeat superior" liability, corporations seem increasingly ready to turn on individuals because that is one of the only ways to mitigate their liability. A corollary is that we have seen the outsourcing of investigations by the DOJ to corporations for reasons of expediency, limited resources, or tactical advantage. This raises the practical issue of to what degree traditional protections for individuals apply when the corporation handles the investigation.

MANSFIELD: This has been a debate for many years: Is it worth prosecuting and convicting corporations to get fines, or is it more important to prosecute individuals? It appeared the DOJ resolved this question a number of years ago in favor of using criminal prosecution primarily as a tool against individuals to achieve the greatest deference within organizations. With the Arthur Andersen collapse following prosecution, the DOJ reexamined how it went about prosecuting organizations and concluded that it would target individuals for prosecution and pursue DPAs with companies. As a result, if you are in-house counsel, CEO, or an executive, your individual conduct is under much greater scrutiny than it was in the past.

MARSHALL: But the opinion in *Ruehle* (*United States v. Ruehle,* No. SACR 08-00138-CJC (C.D. Cal. Dec. 15, 2009)) was strong, and welcomed. It should generate increased pushback on the scope of voluntary disclosures, foregoing cooperation agreements, and the level of cooperation defense counsel now provide to the government on white-collar prosecutions. It essentially gave us an ability to say no. That is, just because the government asks for a waiver, you don't have to suddenly turn over all your work product or privileged materials.

HOCHMAN: Outsourcing is dangerous for the government, just as it is for a business, when you haven't done

the necessary due diligence. The government is basically empowering other actors that it has less control over to become state actors, for which the government then becomes responsible when the case makes it into a courtroom. For example, when the federal government relies on a corporation to obtain its evidence, courts are starting to treat the corporation as a "state actor," which gives the targeted employees constitutional protections that they would otherwise not be entitled to.

RIVERA: Can we extend that logic to the work we do as outside investigators? When we conduct an investigation and report back to the SEC, who in turn uses our work as a data point in determining how to proceed, could that be viewed as a form of outsourcing?

MANSFIELD: The government must be sensitive about how it communicates with the company and counsel conducting the investigation. If the pattern of communication looks like the government is directing the investigation, then it has morphed into outsourcing through a government agent, and that could impose certain obligations and create a problem for the government.

MILLER: But the DOJ has certain advantages in relying on a corporation's internal investigation. First, it's easier to get statements from employees who can be coerced under threat of termination and who may not have a right to counsel. If the corporation took the statements, the individual may not even be able to access them because of privilege issues. Yet, the corporation may provide a privileged summary of the statement to the government. Second, if the corporation is holding on to most of the documents and providing the DOJ with only the incriminating documents, there's no *Brady* review; there is nobody looking at the documents with an eye toward the defendant's interest. So the government will have the documents it wants, but the defendant may be denied evidence necessary to her defense. On the other hand, it's also dangerous for the DOJ. For example, if the corporation is viewed as a government agent, the evidence gathered in the investigation will not be admissible against the individual if it was gathered in violation of her constitutional rights.

MODERATOR: What notable developments have you seen around FCPA enforcement and compliance?

MARSHALL: The SEC has a new FCPA office in San Francisco, and the white-collar community is anxious to see what will happen there. Setting up the office appears to signal an increased scrutiny on technology companies and Silicon Valley. What is different is the fact that the office is in the Bay Area, and Silicon Valley continues to make a big push toward markets in the East. In turn, you have countries like China making a big push to increase their technology. There are countries where the business and government interests are largely one and the same. So there's great risk for our clients in the Valley that have contracts in these countries and that are trying to compete for business on an international level. The bottom line: If you have clients doing business on a global basis, you should be doing a lot of counseling about managing risks and trying to understand the pressures the client is under to maintain its market share and maximize its revenue. The challenge is figuring out how to best help our clients avoid unlawful business practices and compete fairly.

RIVERA: The nexus with the East puts California companies in a unique position with respect to the FCPA, but this is not simply a geographic issue. Many California-based technology companies rely extensively on foreign channel partners to conduct business on their behalf, and this increases their risk for FCPA violations. The DOJ now has a keen appreciation for how channel partners factor into FCPA. Specifically, they have seen cases where bribes were paid by technology companies through marketing development funds, or through excess margin being passed through a distributor or other channel partner. These types of violations are more insidious and are therefore more difficult to investigate.

MANSFIELD: One way to manage FCPA risk is to have a solid compliance program in place. Industries have to look at the recent case involving Panalpina World Transport (*U.S. Sec. & Exch. Comm'n v. Panalpina, Inc.,* No. 4:10-cv-4334 (S.D. Texas, filed Nov. 4, 2010)), and six other companies that resulted in a $236 million settlement, DPAs, and most significantly, the exact same compliance program imposed on each of the companies. So whoever you are, whatever industry you operate in, you need to look at your compliance program and match it up to what was imposed in that case to ensure it satisfies current DOJ expectations.

MARSHALL: Clients are not just concerned about the FCPA; if they are doing business in countries outside the U.S., there's a sense that it's not always a level playing field. The feeling is that while X country allows things to happen one way, the U.S. is forcing companies to operate in a manner in which competitors based in X country do not. This makes our jobs as attorneys much more difficult when counseling clients to comply with complex, and often, ambiguous laws.

SCOTT: FCPA is such a powerful weapon in the DOJ arsenal and yet it is not clearly defined because it hasn't been fully litigated, save a relatively small number of exceptions. Since there aren't many Circuit Court decisions interpreting the FCPA, it really comes down to the eye of the beholder—it's whatever DOJ decides it is in

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terms of jurisdiction or conduct. If you are counseling clients and trying to give them proper advice and recommendations, it's not black and white.

In the United Kingdom, the U.K. Bribery Act of 2010 goes into effect in April 2011. It's the FCPA on steroids. American corporations will be well served to seek advice and get solid counsel on the new law.

MILLER: With regard to the FCPA, there are basic questions that haven't been answered: Who is a public official? What is the required intent? What does "willfully blind" mean in the context of this statute? These questions are all going to get litigated and clarified now, given that the DOJ has focused on individuals, and these individuals are fighting these cases. These are not cases that are going to be resolved by opinion letters and deferred prosecutions.

HOCHMAN: The U.K. law has a compliance-related defense built into it. It's something that the U.S. law has never had, and it encourages companies to set up proper policies and procedures, train employees, and then create an effective regime to actually enforce it. A similar concept is being discussed in the U.S. Congress. If the U.S. were to adopt something similar, it would provide lawyers with more ammunition in their discussions with corporate counsel about how implementing robust compliance regimes can have enormous benefits.

"For the first time since 9/11, there's a white-collar focus again in terms of DOJ's allocation of resources." ***—McGregor "Greg" Scott***

MODERATOR: What are the potential impacts of the whistleblower provisions of Dodd-Frank (Pub. L. 111-203) and what are your thoughts on the proposed SEC rules for implementing it?

MILLER: On the positive side, it's going to increases corporate compliance efforts. On the downside, there is the potential for false complaints because the bounty can be so significant. Another concern is related to the federalization of all internal complaints. I can foresee situations where you are dealing with a country that doesn't have red flag issues, and doesn't have a history of paying bribes, and the employees aren't on notice of potential bribes; for example, unforeseen bribes paid by a third-party agent. In that situation, I think the company should just correct the problem and move on. Dodd-Frank will have the unfortunate impact of causing a potential federal investigation of every complaint.

HOCHMAN: If I were counseling an employee who came across a serious securities violation, I would be hard-pressed to counsel that employee to go to their company's compliance officer first, as opposed to the SEC where they can be first in line for a windfall. To the extent that Sarbanes-Oxley was set up to encourage companies to create compliance programs, and to the extent that a tremendous amount of money has been spent setting up these programs, the whistleblower bounty provision of Dodd-Frank guts the entire effort.

MANSFIELD: Companies that have set up good internal control programs are not going to hear these kinds of complaints on their hotlines anymore, and they are not going to have the opportunity to deal with them appropriately. You might say, "What difference does it make? If there's a crime, it should be investigated and prosecuted." But we all know from the whistleblower statute of the False Claims Act (U.S.C. § 3730(h)) that a large percentage of complaints are bogus. That creates a huge burden for the government, which will have to spend a lot of time reviewing each one, and huge costs for innocent companies.

MARSHALL: By one estimate, the SEC expects 30,000 tips resulting from the whistleblower provisions of the FCPA. They will have to follow up on all of them, with perhaps 5 percent having any validity to them. That's a huge expenditure of resources.

Most companies now have statements in their codes of conduct where employees have affirmative fiduciary duties to report violations of law. So now there is a tension. You have employees looking at their code of conduct and what obligations they have to the company to report upward, versus getting first in line as a whistleblower and reporting directly to the SEC.

MANSFIELD: One of the proposed rules is that employees in the company's compliance department are not allowed to have whistleblower status because they are receiving the hotline complaints and thus are not the first to make the disclosure. But they can claim whistleblower status if the company fails to report a problem to the government in a "reasonable period of time." But what's a "reasonable period of time?" If this proposed rule goes through, are you going to have employees in the compliance department protected against retaliatory action by management who are regularly claiming the time period was unreasonable so that they can qualify for the whistleblower bounty?

RIVERA: The circumstances do suggest that we might find our system bogged down in meritless whisteblower claims. I question how effective cooperation will be between the outside investigators, including lawyers and forensic accountants, who have traditionally been retained to investigate these matters, if the allegations aren't reported to the company directly. How effective is an internal investigation if the professionals conducting the procedures don't have complete access to information about the allegation?

SCOTT: In practical terms, I'm reminded of an experience I had when I was U.S. Attorney. There was an article in the local paper about a task force we put together to address mortgage fraud. The next week, the FBI office was buried in calls from people wanting to report mortgage fraud, and the FBI had to do some massive triaging. So there's no way the SEC is equipped to take on the level of referrals that we are discussing here. Right off the top, they'll have to arbitrarily triage the referrals to reduce that number to something that's manageable.

I completely agree with the observations that DOJ and the SEC have, in recent years, pushed corporate America toward a new culture of compliance, internal programs, and self-reporting. Now, we are moving 180 degrees away from that with the whistleblower provision. It doesn't make a lot of sense, but when the public is genuinely angry about something, politicians don't always react by doing things that are logical or that make sense for the ultimate goal of good corporate citizenship.

MARSHALL: This is one case where the populist movement was counterproductive. We have spent the better part of 20 years counseling clients to set up internal controls and a structure of self-reporting, monitoring, and remediation. The whistleblower provision sounds good, but you don't need it because you already have SEC provisions that deal with corporate governance.

MANSFIELD: It reminds me of criminal legislation. Every time there's a new wave of a particular type of fraud, Congress passes a targeted statute for that particular type of fraud. But in practical terms, it's typically of limited value to prosecutors because they establish more cumbersome mens rea standards and other elements. Their tool kit does not need to be large; it's how you use it. Generally, basic conspiracy, fraud, and false statement statutes can go a long way. The same is true for the SEC. Both enforcement agencies have the ability to

create incentives and disincentives for companies that lack integrity or that don't have effective compliance programs. They ought to use previously existing enforcement powers to make sure companies are in compliance—it's the most economically efficient way to make sure business behaves. And we can't forget the plaintiffs bar, which has the power to bring cases and represent people who are making allegations of securities fraud. The Dodd-Frank whistleblower program is unnecessary and inefficient.

HOCHMAN: The fundamental, inaccurate assumption that these whistleblower programs are based on is that more and better cases will arrive if the government provides a financial incentive. The most famous, recent case belying this assumption is the one related to Bernie Madoff. The person who alerted the SEC about Madoff's scheme years ago did not do so because he was incentivized by a bounty. The problem has not been the quantity or quality of the tips but the resources available to follow up on them. If you want to deal with this problem, triple the SEC enforcement budget. With the SEC poised to get 30,000 tips via whistleblowers without adequate resources to properly investigate them, the SEC is being set up for failure.

RIVERA: One way to increase the likelihood that an allegation is properly investigated is to retain an objective and qualified outside law firm and/or forensic accounting firm to conduct the investigation. We can also look to the auditing profession to help ensure that allegations are properly investigated. Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.) in effect requires auditors to determine that their clients appropriately investigate potential illegal acts and implement reasonable remedial actions based on the investigation findings.

MODERATOR: What additional cases or trends are you watching and why?

SCOTT: I am looking at the honest services statute (18 U.S.C. § 1346) in light of the U.S. Supreme Court decision earlier in the year (*Skilling v. United States,* 130 S. Ct 2896 (2010)). Sen. Patrick Leahy has introduced legislation that would revive many of the traditional uses of the honest services statute by prosecutors, which were struck down by the *Skilling* case. U.S. Supreme Court Justice Antonin Scalia made some great observations on the *Skilling* matter: How can you prosecute somebody when what's criminal isn't clearly defined until somebody brings a case against you? Five years from now we may be back in the honest services business because of the new legislation attempting to "fix" the Supreme Court decision.

HOCHMAN: I'm following DOJ's nationwide efforts to institute updated *Brady* policies to address the timely and complete turning over of exculpatory information to the defense. The recent *Brady* debacle in the Ted Stevens case (*United States v. Theodore Stevens,* CR No. 08-231(EGS) (D.D.C. 2008)) that resulted in the new disclosure policies being implemented sound great on paper but their true test will be how line prosecutors live up to the lofty language and promises.

In the criminal tax arena, there's a push toward international tax enforcement. It's estimated that there's $40 billion to $70 billion annually that goes unreported overseas. The Internal Revenue Service (IRS) is committed to devoting significant resources to follow this money wherever in the world it may go. More agents are being hired and trained to handle these cases; they are tracking money across international borders by using Mutual Legal Assistance Treaties (MLAT), Tax Exchange Information Agreements (TEIA) and other bilateral treaties, which allow the IRS to receiver better cooperation and information from abroad. The *UBS* case (*United States v. UBS AG,* Civil No. 09-20423 (S.D. Fla. 2009)) has shown that the formally impregnable walls of Swiss banking are now crumbling down. The IRS and DOJ Tax Division have indicated their intent to follow up on their initial success in Switzerland by bringing cases in other regions. Enormous waves of prosecution will result.

MANSFIELD: What's interesting about the offshore tax cases is that they may not be just tax cases; prosecutors are examining whether other criminal reasons lead people to put money into these undisclosed accounts. With respect to other trends, we are going to see more insider trading cases and not just in the hedge fund industry. Lastly, I am watching what is going on in Washington, D.C., with respect to Inspectors General. There are some Republican efforts to beef up their powers, which could increase the number of investigations in health care, procurement fraud, and public corruption.

MARSHALL: Another area of interest is cybercrime. A number of clients have expressed concern about their IT security, data storage, information retrieval, and code protection. Companies are concerned about how information flows and travels worldwide. All of this is related to data management protection and the myriad of legal problems that arise when a company's systems have been invaded, misused, or corrupted.

SCOTT: Rep. Darrell Issa has publicly stated that he intends to hold a number of hearings on an array of topics as the chair of the House Committee on Oversight and Government Reform. There will be an investigation into the sweetheart deals that Countrywide gave out, and an investigation into executive branch agencies, which may have the collateral effect of spurring those agencies to take more enforcement efforts in particular areas. It's also going to be interesting to see the budgetary issues for prosecutors' offices in this coming year at local, state, and federal levels. I predict that this year, we are going to see more California district attorneys' offices closed several times per month to make up for budget shortfalls. At the federal level, they've managed to skirt this issue in 2010 by continuing resolutions without passing a budget so that the agencies can continue to operate at 2009 budget levels. That's not going to happen in 2011.

MILLER: I'm watching whether the DOJ will pursue individuals in off-label promotion cases as they have in FCPA cases and the interesting issues that will arise. The government's position has traditionally been that under the Responsible Corporate Officer Doctrine, there's strict liability for people in the health care industry who are in a position to stop or prevent harm. I'm interested in seeing if the strict liability principle, which was applied by the U.S. Supreme Court in *United States v. Park* (421 U.S. 658 (1975)) and involved $50 fines, will apply today when the consequences for violations are much greater. And given the focus on off-label promotion, I'm also interested in the interplay between pharmaceutical companies' First Amendment right to educate doctors, and the doctors' First Amendment right to get information, versus the government's interest in prohibiting this exchange.

RIVERA: I'm interested in the decision by the D.C. Circuit Court in the Dow Chemical case (*United States v. Deloitte LLP,* 610 F.3d 129 (D.C. Cir. 2010)) related to the audit work papers of Deloitte. This decision essentially establishes that the disclosure of audit work papers to a public accounting firm does not waive the work-product privilege. This is a tension I've seen with increasing frequency as auditors seek to understand the scope, procedures performed, and findings of investigations of their audit clients in accordance with Section 10A. The auditor's requests for information about an investigation can create tension with the client and their counsel, who understandably want to protect privileged information as much as possible. There have been a number of recent decisions that are helpful here, but the Dow Chemical case, most notably, makes it easier for clients to share information with their auditors, which is helpful in fostering cooperation and trust when there is an investigation. ■