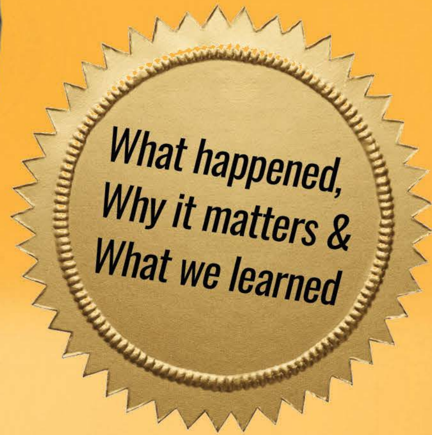
Corporate Compliance Insights

Not Your Father's FCPA

Summer 2016: the New Era of Enforcement



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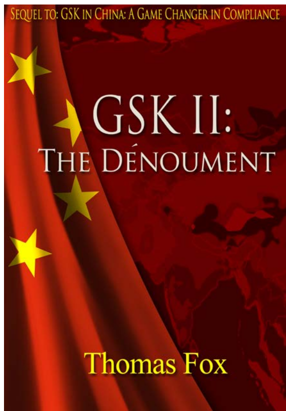

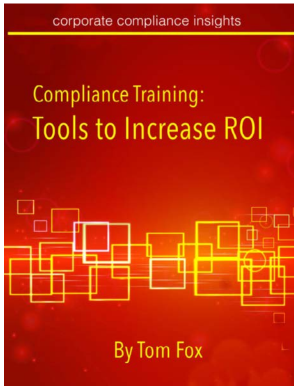

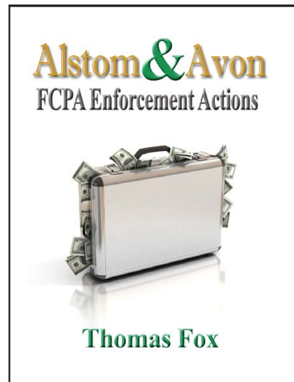

Not Your Father's FCPA

Summer 2016: The New Era in Enforcement

Thomas Fox

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Corporate Compliance Insights educates and encourages informed interaction within the corporate compliance community by providing discussion and analysis of corporate compliance, risk assessment, ethics, audit, and corporate governance topics. In adherance to strict journalistic standards, CCI publishes the works of GRC experts and thought leaders from around the world. CCI's founder and publisher is Maurice Gilbert, CEO and managing partner of Conselium, a compliance-focused executive search firm.

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Author's Note

The year 2016 is on its way to being one for the FCPA record books. From the number of enforcement actions announced in February to the busy three-month summer period, we've seen case after case emerge. This book continues my series of short works designed to provide clear and useful guidance to the compliance practitioner on a topic specific to anti-corruption compliance. Thanks to Maurice Gilbert, Founder of Corporate Compliance Insights and Conselium Search, for providing me a platform to publish my book, and to my heart-of-gold wife, Michele, for editing it.

Introduction

This has been quite a year in terms of the enforcement of the Foreign Corrupt Practices Act (FCPA). In February, there were as many FCPA enforcement actions as there were in all of 2015. Yet the summer of 2016 brought some significant enforcement actions that may well portend long-term changes in the FCPA. This e-book will explore these enforcement actions, discuss the underlying facts of each and provide lessons for the compliance practitioner. I will also look at the enforcement actions in the context of the Yates Memo and the recently announced change in the way the Department of Justice (DOJ) will assess damages in its prosecutions based on the FCPA Pilot Program, announced in April 2016.

Chapter 1
Akamai and Nortek

Background Facts

It certainly did not take long for companies to see the benefit of the DOJ FCPA Pilot Program around FCPA enforcement. Recently appointed Deputy Chief of the DOJ Criminal Division Fraud Section and head of the FCPA Unit, Daniel Kahn, issued letters to both Akamai Technologies, Inc. (Akamai) and Nortek Inc. (Nortek) in June, declining to prosecute both companies for their admitted FCPA violations.

Also, most interestingly, both parties received non-prosecution agreements (NPAs) from the Securities and Exchange Commission (SEC). Akamai agreed to profit disgorgement in the amount of $652,452, together with prejudgment interest thereon in the amount of $19,433 within 15 days of the signing of the NPA. Nortek agreed to profit disgorgement in the amount of $291,403, together with prejudgment interest thereon in the amount of $30,655 within 15 days.

Akamai

As set out in the SEC's NPA, Akamai is a U.S. stock-listed company that "provides cloud services for delivering, optimizing and securing online content and business applications over the internet ('internet capacity and services') and maintains operations in North America, Europe and China." "Akamai (Beijing) Technologies, Co. Ltd ('Akamai-China') is a wholly owned subsidiary of Akamai located in Beijing, China. Akamai-China provides technical and sales support to its local Chinese channel partners for content delivery services, which are resold by channel partners in China."

Akamai-China was "required to contract with third-party channel partners to deliver its services to end customers. From at least 2013 through 2015, a Regional Sales Manager for Akamai-China (the 'Regional Sales Manager') concocted a scheme with a channel party to bribe employees of three end customers, two of which were Chinese state-owned entities, to obtain and retain business. The bribes were paid to induce the end customers' employees, including the employees of the Chinese state-owned entities (hereinafter the 'Chinese government officials'), to contract to purchase up to 100 times more network capacity from the channel partner than each company actually needed." To top it off, the Channel Partner would then purchase this capacity from Akamai-China, add its own markup and sell the capacity to the end customers. It was a very neat way to fund a bribery scheme.

To induce the end user to contract with Akamai-China, the Channel Partner would pay monies from these bogus sales to the Regional Sales Manager's accounts. As noted in the NPA, "The Regional Sales Manager then paid a portion of these funds, and also provided expensive gifts, to employees of the three end customers. Overall, the Regional Sales Manager paid approximately $155,500 to employees of end customers, including approximately $38,500 in cash to Chinese government officials."

Yet the bribery scheme did not stop there, as employees of "Akamai-China routinely provided improper gifts and entertainment to employees of its end customers, some of whom were Chinese government officials, to obtain or retain business. The gifts and entertainment given to Chinese government officials totaled approximately $32,000 and were provided in violation of Akamai's corporate governance and internal accounting controls policies. Akamai-China improperly recorded the gifts and entertain-

ment to Chinese government officials as legitimate business expenses."

As you might presume from such a systemic failure around Akamai-China's anti-corruption program, there were FCPA accounting provisions failures in both internal controls and books and records. There were multiple internal controls failures that allowed the Akamai-China bribery scheme to go undetected. The NPA pointed to the company's failure "to provide reasonable assurances, among other things, that transactions were executed in accordance with management's general or specific authorization and transactions were recorded as necessary to maintain accountability for assets. Akamai's internal accounting control failures included: the lack of formalized due diligence of China-based channel partners, the failure to proactively exercise audit rights to ensure compliance with anti-bribery policies, failure to monitor or review customer usage in high-risk regions, failure to translate anti-bribery and anti-corruption policies into Mandarin, inadequate employee training on compliance and anti-bribery policies and the lack of effective procedures for reviewing and approving business entertainment."

There were multiple internal controls failures that allowed the Akamai-China bribery scheme to go undetected.

Both Akamai-China's and the parent company's books and records were inaccurate because Akamai-China had made improper payments, in the form of gifts and entertainment, which were inaccurately recorded as legitimate business expenses. These inaccurate subsidiary financials were subsequently consolidated with Akamai's books and records, rendering Akamai's books and records inaccurate.

Nortek

As set out in its NPA, Nortek is a U.S. stock-listed company that manufactures and sells a wide variety of products for residential and commercial construction and remodeling, as well as for the personal and enterprise computer markets, including heaters; range hoods; heating, ventilation and air conditioning systems; and garage door and security systems. Nortek had an indirect subsidiary, Linear Electronics (Shenzhen) Co. Ltd. (Linear China), which provided manufacturing services for Nortek in China. Both companies had operations in China, where they violated the FCPA.

According to its NPA, from at least 2009 to 2014, the Managing Director of Nortek's Chinese subsidiary, together with the "accounting manager, customs liaison officer and other employees made or approved improper payments and gifts to local Chinese officials in order to receive preferential treatment, relaxed regulatory oversight and/or reduced customs duties, taxes, and fees." There were over 400 illegal payments made, totaling approximately $290,000. The payments and gifts "to local Chinese officials included cash payments, gift cards, meals, travel, accommodations and entertainment. Linear China made the illicit payments to local officials from multiple different governmental departments, including customs, tax, fire, police, labor, health inspection, environmental protection and telecommunications."

Nortek failed to notice obvious red flags, including the number and size of meals and entertainment expenses.

Further, Nortek had a systemic failure in its internal controls that led to these FCPA violations. Its NPA stated, "Nortek failed to devise and maintain a system of internal accounting controls at Linear China sufficient to provide reasonable assurances that, among other things, transactions were executed in accordance with management's general or specific authorization, and transactions were recorded as necessary to maintain accountability for assets. Linear China made improper payments from multiple accounts, which Nortek failed to review or test. Nortek failed to notice obvious red flags in Linear China's financial records, including the number and size of Linear China's meals and entertainment expenses." Belying the recent criticism of training, "Nortek failed to establish procedures to ensure its Linear China employees were trained in anti-corruption compliance." Nortek also failed to accurately record these payments on its books and records.

There was no information presented on the size of any specific or particular payment made by either Akamai or Nortek. While it is not clear from the Nortek NPA whether some of the payments made might fall under the facilitation payment exemption to the FCPA, it was clear that the company did not correctly record the payments in its books and records.

How to Garner an NPA and Declination

In a similar letter to both companies, Deputy Chief Kahn stated, "Based upon the information known to the Department at this time, we have closed our inquiry into this matter. Consistent with the FCPA Pilot Program, we have reached this conclusion despite the bribery by an employee of the Company's subsidiary in China and one of that subsidiary's channel partners, based on a number of factors, including but not limited to Akamai's prompt voluntary self-disclosure of the misconduct, the thorough investigation and fulsome cooperation by the Company (including by identifying all individuals involved in or responsible for the misconduct and by providing all facts relating to that misconduct to the Department) and its agreement to continue to cooperate in any ongoing investigations of individuals, the steps that the Company has taken to enhance its compliance program and its internal accounting controls, the Company's full remediation (including promptly suspending at the start of the investigation the individual involved in the China misconduct who then resigned shortly thereafter, terminating the relationship with the channel partner involved in the misconduct, and disciplining five other employees who should have prevented other violations of the Company's policies) and the fact that Akamai (or Nortek) will be disgorging to the SEC the full amount of disgorgement as determined by the SEC."

In unpacking Kahn's letters, there are several key factors for any CCO who may find his company under an FCPA investigation.

Voluntary Self-Disclosure

Nortek's NPA reported that even before completing its internal investigation, Nortek promptly self-reported its preliminary findings to both the SEC and the DOJ. The internal investigation was deemed thorough, as "Nortek conducted an internal audit of Linear China's books and records. The internal audit team identified questionable payments made to local Chinese officials." Based on the preliminary information, "Nortek conducted an internal investigation of Linear China's conduct and forensically analyzed Linear China's financial records. The internal investigation confirmed Linear China had made improper payments to Chinese officials local to Shenzhen, China."

Akamai also promptly self-reported its actions and conducted a timely and thorough investigation. The company was made aware of the allegations through an internal whistleblower who reported the "Regional Sales Manager had received improper payments from channel partners and had made improper payments to end-customer employees to secure business." The NPA noted, "Within weeks, Akamai voluntarily disclosed its investigation to the Commission staff and the Department of Justice."

Extensive Cooperation During Investigation

Both companies engaged in extension cooperation during the pendency of the investigation. Akamai provided comprehensive, organized and real-time cooperation with the both the SEC and DOJ, "including: (i) sharing the detailed findings of its internal investigation, including the results of its audits of its Chinese channel partners, analyses of customer usage versus purchased capacities, summaries of witness interviews and factual chronologies and supporting documentation; (ii) identifying and presenting relevant documents to the staff; (iii) timely updating the staff with additional findings when its investigation uncovered new information; (iv) proactively updating the staff on its remedial measures, including updates to its compliance policies and procedures; (v) voluntarily translating documents from Chinese into English; and (vi) voluntarily making witnesses available for interviews and testimony."

Nortek's NPA stated they "provided comprehensive, organized and real-time cooperation with the staff of the [SEC] during the course of its internal investigation, including: (i) sharing the detailed findings of its internal investigation, including identifying all improper payments and potential improper payments made to foreign officials and providing its summaries of witness interviews; (ii) timely updating the staff with additional findings when its investigation uncovered new information; (iii) effectively segregating, organizing and presenting the most salient documents to the staff; (iv) voluntarily translating documents from Chinese into English; (v) voluntarily making witnesses available for interviews, including those in China; and (vi) conducting a risk assessment to determine whether the improper conduct at Linear China occurred at Nortek's other manufacturing locations in China."

Remediating the Compliance Program

Both companies extensively remediated their compliance programs during the investigations. Akamai terminated both the Regional Manager involved in the conduct and the channel partner. Nortek terminated the employees at Linear China after they were interviewed for the internal investigation. It was also noted that those terminated included "Linear China's managing director and chief financial officer."

Beyond this, Nortek "(i) revised its internal audit testing and protocols to focus on quickly discovering any FCPA-related improprieties; (ii) strengthened its anti-corruption policies; (iii) developed a Compliance Committee consisting of representatives from management and subsidiaries to supervise compliance implementation of Nortek's policies and training; (iv) provided extensive mandatory in-person and online trainings on the FCPA and anti-corruption policies to its employees around the globe in appropriate languages; and (v) adjusted its internal audit schedules to prioritize facilities located in geographic areas known for higher incidences of corruption."

Akamai, as stated in its NPA, "(i) implemented comprehensive due diligence processes for channel partners, including engaging an outside consultant to conduct channel partner risk assessments; (ii) strengthened its anti-corruption policies; (iii) implemented enhanced compliance monitoring functions and structures, such as naming a Chief Compliance Officer and staffing a global team of dedicated compliance professionals in Europe, the U.S. and Asia; (iv) provided extensive mandatory in-person and online trainings on FCPA and anti-corruption policies to its employees around the globe in appropriate languages; and (v) enhanced its travel and expense control requirements in China, including requiring more detailed expense descriptions and supporting documentation and appointing an independent function with Chinese language capability to review and approve expense claims."

I would have thought it almost self-evident that it would be mandatory to translate documents into English.

Next, a word about translations: I would have thought it was almost self-evident that in any FCPA investigation, it would be mandatory to translate

into English foreign language documents. However, in both NPAs, the SEC specifically mentioned the respondents' "voluntarily translating documents from Chinese into English." I guess there are still companies out there that have not gotten the message that documents have to be translated into English. So call Mr. Translations, Jay Rosen, and he will explain to you how to accomplish this requirement.

You should use both of these NPAs as guideposts to benchmark your company's compliance program, as the DOJ and SEC favorably commented on the remediation steps both entities engaged in. In other words, there were lessons on the actual doing of compliance that are significant for the compliance professional.

The Nortek NPA outlines the following steps the company took:

1. Revising its internal audit testing and protocols to focus on quickly discovering any FCPA-related improprieties;
2. Strengthening the company's anti-corruption policies;
3. Developing a Compliance Committee consisting of representatives from management and subsidiaries to supervise compliance implementation of Nortek's policies and training;
4. Providing extensive mandatory in-person and online trainings on the FCPA and anti-corruption policies to its employees around the globe in appropriate languages (there's that translations issue again); and
5. Adjusting its internal audit schedules to prioritize facilities located in geographic areas known for higher incidences of corruption.

The Akamai NPA outlines the following steps the company took:

1. Implementing comprehensive due diligence processes for channel partners, which included engaging an outside consultant to conduct channel partner risk assessments;
2. Strengthening the company's anti-corruption policies;
3. Implementing enhanced compliance monitoring functions and structures, such as naming a Chief Compliance Officer and staffing a global team of dedicated compliance professionals in Europe, the

U.S. and Asia;

4. Providing extensive mandatory in-person and online trainings on FCPA and anti-corruption policies to its employees around the globe in appropriate languages; and
5. Enhancing the company's travel and expense control requirements in China, including requiring more detailed expense descriptions and supporting documentation and appointing an independent function with Chinese language capability to review and approve expense claims.

Profit Disgorgement

Both companies disgorged the profits they generated from their FCPA-violative conduct. The language in each NPA, "to pay disgorgement obtained or retained as a result of the violations discovered during the Investigation," does not provide any insight into how the amount was calculated or what transactions this profit disgorgement was based on.

Chapter 2
Analogic

The next FCPA resolution involved Analogic Corporation (Analogic) and Lars Frost (Frost), a former Chief Financial Officer (CFO) of its wholly owned Danish subsidiary BK Medical ApS (BK Medical). BK Medical settled its outstanding FCPA enforcement action with the DOJ separately via an NPA. BK Medical agreed to pay a fine of $3.4 million. In a settlement with the SEC, resolved via a cease and desist order (Order), Analogic agreed to pay $7.7 million in disgorgement and $3.8 million in prejudgment interest. Frost agreed to a fine of $20,000.

Analogic is a medical device manufacturer headquartered in Massachusetts, primarily manufacturing ultrasound equipment. Its vehicle for sales in Russia, as well as other countries, was its Danish subsidiary BK Medical and through distributors. It was through this mechanism that the bribery and corruption was facilitated. And what a bribery scheme it was.

The SEC Order stated, "From at least 2001 through early 2011, BK Medical participated in hundreds of highly suspicious transactions at its distributors' direction which posed a significant risk of bribery or other improper conduct. The suspicious transactions involved BK Medical's distributor in Russia, as well as, to a lesser extent, its distributors in Ghana, Israel, Kazakhstan, Ukraine and Vietnam. The transactions routinely involved fictitious invoices issued by BK Medical at inflated prices, overpayments to BK Medical from the distributors against the inflated invoices and subsequent payments by BK Medical out of the distributors' excess funds to unknown third parties all over the world for unknown reasons. In short, for at least nine years, BK Medical acted as a conduit for its distributors to funnel money to parties, and for reasons, unknown to BK Medical. Approximately $20 million flowed through BK Medical from these distributors, with over $16 million from BK Medical's Russian distributor."

In his CFO office at BK Medical, Frost "personally authorized approximately 150 conduit payments to unknown third parties … despite knowing that the payments violated BK Medical's internal accounting controls. Frost also submitted numerous false quarterly sub-certifications to Analogic."

False Contracts and Bogus Invoices

The SEC Order gave exacting detail on how the illegal payments were created and funded. "The first step involved the creation of one or more fictitious documents reflecting an inflated purchase price for the product or products BK Medical was selling to the Russian distributor." From there, "the Russian distributor would request that BK Medical create a fictitious, second invoice at an inflated price. The Russian distributor would send BK Medical a template invoice with the inflated price, which was regularly well in excess of 100 percent of the original, agreed-upon price. BK Medical's distributor sales staff understood the inflated price to reflect the price the ultimate end user would pay to the distributor."

BK Medical would then "cut and paste BK Medical's logo onto the template invoice and complete other pertinent fields, such as an invoice number. These steps were taken outside BK Medical's standard invoice-generation system, in violation of BK Medical's internal accounting controls. The fictitious, second invoice would subsequently accompany the ultrasound products when they were shipped to Russia. An invoice prepared by BK Medical's standard invoice generation system reflecting the agreed-upon, actual price would also be sent to the Russian distributor."

Next, the Russian distributor would send BK Medical a bogus contract at this higher price that the Danish-subsidiary would approve. The Russian distributor would then pay against the bogus contract and invoice. BK Medical would book the true or original contract price and credit the excess amount to the Russian distributor.

As set out in the NPAs, in addition to these fake contracts, with their attendant payments, the Russian distributor "would send BK Medical an invoice

that purported to be from the third-party entity that was to receive a payment from BK Medical. These invoices referred to services being rendered to BK Medical as, among other things, 'marketing,' 'logistic service' and 'commission.' BK Medical employees have confirmed that none of these entities actually rendered any services to BK Medical and that they understood this fact at the time these invoices were received by BK Medical."

Payments Based on False Documents

Of course, this excess amount had to be sent somewhere for a bribe to be paid and sent somewhere the payments were. The SEC Order stated, "Then, at some point weeks or months later, the Russian distributor would direct BK Medical to make a wire payment out of the excess funds to a third party that was otherwise unknown to BK Medical. BK Medical complied with the directives, despite not knowing the purpose of the payments or the nature of the payees." The payees were largely shell companies located in the usual locations for suspicious payments: Belize, the British Virgin Islands, Cyprus and the Seychelles and made payable "to specific individuals in Russia."

All of these payments were made outside of and in violation of Analogic's internal controls. Over a 10-year period, these payments totaled approximately $16.1 million and BK Medical recorded over $21.6 million in profits from these transactions. There were other countries where this or a similar distributor-based bribery funding mechanism was used. These countries were "Ghana, Israel, Kazakhstan, Ukraine and Vietnam," to the tune of some $3.8 million.

As blatant as all of the above was in terms of an overt bribery program, it did not pass unnoticed. As early as 2004, BK Medical's Vice President (VP) of Sales asked the purpose of the payments. He was told, "Russian market conditions." Moreover, in 2008, Analogic recognized the potential for FCPA violations by BK Medical. The parent corporation provided training to BK Medical, but it stopped there and did not inquire further into the Russian agent. So, red flags were identified and raised, yet there was no follow-up action by the corporate parent.

Lessons from Analogic

The scheme was a complete bribery program, facilitated at the highest levels of the Danish subsidiary. The Danish subsidiary had numerous mechanisms to fund the bribes paid across multiple countries. However, the parent company, Analogic, had not and did not put sufficient internal controls in place to detect or prevent this conduct. In addition to the violation of the internal controls provisions of the FCPA, both BK Medical and its parent did not accurately book these payments, so there was also a violation of the accounting provisions.

In an FCPA Blog post entitled, "The Analogic Settlement: What's behind the issue of cooperation credit," Ann Klibaner Sultan and Marc Alain Bohn laid out four key areas of inquiry which they raised. They were:

1. High-level accounting failures, as it does not get much higher than the CFO. Sultan and Bohn said, "Among other things, Frost submitted numerous false quarterly sub-certifications to Analogic and knew and failed to disclose the fake contracts requested by the distributor, despite his responsibility of completing quarterly checklists designed to identify unusual transactions for Analogic's controller."
2. Unknown third parties. Here they wrote, "Significantly, BK Medical did not know or have a business relationship with the third parties to whom it was making payments."
3. Novel Distributor Overpayment Scheme to Generate Funds. (The bribery program BK Medical engaged in is outlined above.)
4. Conduct Flagged Twice over a 10-Year Period without Being Stopped. Sultan and Bohn noted that in addition to the two separate red flags raised by senior officials of the company in 2004 and 2008, Analogic never followed through to ensure thorough remediation. Indeed, one almost wonders what the company uncovered in 2011 that led to Analogic "flagging the distributor scheme," and then proceeding to discontinue the distributor payments, conducting an internal investigation and self-disclosing the misconduct to U.S. enforcement authorities. I would have thought that anyone or perhaps two of these factors would have been enough to slap a serious criminal penalty on Analogic, yet the company only sustained a civil-side FCPA enforcement action, and BK Medical only received an NPA.

There is one anomaly here that bears some discussion. In a somewhat odd rejoinder to point two above, the NPA stated, "the Company did not receive full cooperation credit because… the Company's cooperation subsequent to its self-disclosure did not include disclosure of all relevant facts that it learned during the course of its internal investigation; specifically, the Company did not disclose information that was known to the Company and Analogic about the identities of a number of the state-owned entity end users of the Company's products, and about certain statements given by employees in the course of the internal investigation." Put another way, it is difficult to understand how Analogic could be faulted by the SEC for its subsidiary not knowing whom it was doing business with when the DOJ turns around and says the subsidiary knew but did not disclose the information to the DOJ.

Clearly, the DOJ is committed to giving companies credit if they will follow the new Pilot Program.

Whatever the answer might be, BK Medical did not receive the fully available discount of 50 percent of the minimum of the low end of the Sentencing Guidelines for its DOJ-imposed fine. BK Medical did receive a 30 percent discount, presumably because of its remediation going forward.

The bottom line for the Chief Compliance Officer (CCO) or compliance practitioner is that even with senior management involvement, you can make a comeback toward a very reasonable fine and penalty. Clearly, the DOJ is committed to giving companies significant credit if they will follow the strictures of the new Pilot Program. I cannot imagine a much more egregious bribery program than the one engaged in by Analogic's Danish subsidiary, yet both Analogic and BK Medical appear to have done quite well in their respectively low penalties.

Chapter 3
LATAM/LAN

Some Questions

What is the cost of an FCPA violation? A subset of that question is: what is the cost of not cooperating and not remediating during the pendency of such investigations? Those were two of the questions that seemed to permeate the July conclusion to the long-running FCPA matter involving the LATAM Airlines Group S.A. (LATAM). The settlement documents released included an information detailing the criminal charges, a deferred prosecution agreement (DPA) and a Securities and Exchange Commission (SEC) cease and desist order (Order) outlining the civil violations. LATAM's predecessor-in-interest is LAN Airlines S.A. (LAN).

But before we get to any of these factors, the question I was asked the most about this case was this: who was the foreign official bribed in this matter? I have read the information outlining the criminal conduct and the criminal charges brought; the DPA, the DOJ press release and the SEC Order outlining the civil violations involved. The bribe payments were made by a LAN Consultant, who was an Argentine government official, to labor union officials in Argentina to secure labor peace for the airline. This person was only identified as "Consultant" in the Information and was further identified in the Order as a Cabinet Advisor in the Ministry of Federal Planning, Public Investment and Services, Department of Transportation. On January 31, 2005, the Secretary of Transportation appointed the consultant as a Cabinet Advisor "ad-honorem," pursuant to an unpublished Resolution. This consultant, a foreign government official under the facts of this case, who made $1.15 million in corrupt payments to Argentinian labor unions.

The bribery scheme was a fairly standard, uninspired scheme in comparison to some of the schemes we have recently seen in FCPA enforcement actions. The pedestrian bribery program was probably due to the fact there was no need to hide it from senior management as it involved, according to

the information, a "high-level executive at LAN." (LAN was the predecessor of LATAM). Through this LAN executive "LAN negotiated and executed a fictitious $1.15 million consulting agreement with Consultant, through a company he owned and operated, in order to funnel bribes to labor union officials."

The contract was a sham from the start and was used to funnel money to the Consultant to pay bribes.

Of course, the agreement was never signed by the corrupt LAN executive, nor were any of the terms and conditions of the Consultant's services ever delivered. Indeed, it was this LAN executive who instructed the company's Chief Financial Officer to make the corrupt payments. In short, the contract was a sham from the start and was simply used to funnel money to the Consultant to pay bribes to labor union officials to keep the peace. Another LAN subsidiary was created to make the corrupt payments and, even then, the payments made to the Consultant were to his bank account in the U.S. The relevant time period of the bribe payments was 2006-2007.

While LAN may not have been a completely corrupt organization, about the best thing one can say about the company is that it had no commitment to compliance. They did not have any person tasked with heading the compliance function until at least 2008. It was not until 2013 that LATAM adopted a code of conduct that included anti-corruption provisions. Finally, it was not until 2014 that the company even bothered to implement a new compliance program that included, according to the Order, "an anti-corruption guide; a gifts, travel, hospitality and entertainment policy; an escalation policy; and procurement and payment policies."

This is one of the rare FCPA enforcement actions where a criminal violation of the accounting provisions is found. There were violations of both the books and records and internal controls provisions. Regarding the books and records provisions, the information stated that LATAM "knowingly and willfully falsified and caused to be falsified its books, records, and accounts and did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions, to wit: the defendant knowingly falsified records relating to the retention and nature of services of, and payments to, Consultant in order to conceal the true purpose of retaining Consultant."

Regarding the internal controls provisions, the information stated, "During the relevant period, LAN knowingly and willfully failed to implement a sufficient system of internal accounting controls. In particular and as relevant here, LAN had deficient internal accounting controls that did not require, among other things, (a) due diligence for the retention of third party consultants; (b) a fully executed contract with a third party before payment could be made to it; (c) invoices issued to the LAN entity that in fact engaged the third party; (d) documentation or other proof that services had been rendered by a third party before payment could be made to it; (e) that payment to third parties retained by LAN or LAN entities be made to bank accounts held in the names of those third parties; or (f) oversight of the payment process to ensure that payments were made pursuant to appropriate controls, including those described above."

In addition to the conduct detailed above, LAN did not self-disclose the FCPA violations to the DOJ and did not cooperate with the DOJ and SEC until some point later in the investigation. LATAM paid a stiff amount for its recalcitrance. As was stated in the DOJ press release, "LATAM agreed to pay a $12.75 million criminal penalty, continue to cooperate with the department's investigation, enhance its compliance program and retain an independent corporate compliance monitor for a term of at least 27 months." The company also paid a hefty SEC penalty; "it agreed to pay $6.74 million in disgorgement and $2.7 million in prejudgment interest." The total amount was $22.2 million in fines and penalties.

Finally, as was stated in several places in the resolution documents and cited in the DOJ press release, "LATAM failed to discipline in any way the employees responsible for the criminal conduct, including at least one high-level company executive, and thus the ability of the compliance program to be effective in practice is compromised." All of this means the individual referred to as the LAN executive is still in the company and most probably still an executive.

This enforcement action also saw the re-emergence of the requirement for a corporate monitor. The period of the monitorship was listed at 27 months and is charged with evaluating the effectiveness of the company's new compliance program and compliance with the FCPA. The monitor is also mandated to assess the board of directors' and senior management's com-

mitment to the corporate compliance program.

Observations

With $22.2 million in combined penalties and disgorgement, the cost to LATAM was not insignificant.

This settlement bookends the civil settlement with current LATAM President Ignacio Cueto, reached in February 2016. Under the SEC cease and desist order (Cueto Order), Cueto agreed to a civil penalty of $75,000 for both approving an Argentinian official to act as a consultant for the company and approving a payment of $1.15 million to this consultant understanding, at the time, "that it was possible the consultant would pass on some portion of the $1.15 million to union officials in Argentina." In addition to the aforementioned fine, he agreed to receive anti-corruption training for senior executives of the company.

The company clearly did not take compliance very seriously at the time of the incidents giving rise to this enforcement action, nor did it apparently take seriously any potential FCPA liability. As noted in the DOJ press release, "LATAM did not voluntarily disclose the FCPA violations," and in not self-disclosing, compromised certain evidence in the matter. During the pendency of the investigation, they "did not, however, remediate adequately. LATAM failed to discipline in any way the employees responsible for the criminal conduct, including at least one high-level company executive [Cueto listed above], and thus the ability of the compliance program to be effective in practice is compromised."

At some point, the company did see the light and began to "cooperate with the department's investigation after the press in Argentina uncovered and reported the conduct approximately four years after it had occurred. After LATAM began cooperating, it did so fully and provided all relevant facts known to it, including about individuals involved in the misconduct." The DPA reflected this lack of cooperation in the paucity of discounting factors, and "As a result, the company paid a penalty within the U.S. Sentencing Guidelines range instead of receiving a discount off the bottom of the range."

The DOJ clearly did not credit the company for its recalcitrant conduct before and during the investigation. However, as laid out in the DPA, the fine range was $10.2 million to $20.4 million, so the company did obtain a DOJ fine in the lower range of the Sentencing Guidelines. Yet again, the clear message from the DOJ is that the conduct of a company can, will and does lead to receiving credit, and such credit can lead to a lower fine or – in the cases of Johnson Controls, Inc., Akamai Technology, Inc. and Nortek Corporation – declinations to prosecute.

This is one of the rare cases of an agreed criminal charge of the accounting provisions of the FCPA.

I think a couple of other observations are in order for this matter. First, the foreign official was paid some amount of money for fraudulent services. The consultant, a government official during the relevant times, was given money to pay a bribe. From the Cueto Order, it appears the consultant may well have kept some portion of the $1.15 million destined to bribe the Argentinian labor union officials. How much this consultant kept and would have constituted his bribe has not been reported.

There is something else about this case that makes it most interesting and may well portend a new direction of FCPA enforcement: This is one of the rare cases of an agreed criminal charge of the accounting provisions of the FCPA. The FCPA itself specifies that violations of the accounting provisions become criminal matters under two conditions, found under 15 U.S.C. § 78m [Section 13 of the Securities Exchange Act of 1934].

(4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection except as pro¬vided in paragraph (5) of this subsection.
(5) No person shall knowingly circumvent or knowingly fail to imple¬ment a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2).

There is nothing in this language tying it to the foreign official requirement found in sections detailing prohibited practices by issuers (15 U.S.C. § 78dd-1) or domestic concerns (15 U.S.C. § 78dd-2). This might mean that a company that engages in private or commercial bribery and tries to

disguise it through falsification of books and records, as the senior management of LATAM did, could be prosecuted for an FCPA violation. So the next time bribes are paid to a union official, even without using a foreign government representative to facilitate the bribe payment and without recording the bribe as a bribe, a criminal FCPA violation could result.

Once again, the DOJ has demonstrated the benefits a company will receive by self-disclosure. One only has to compare this matter with the first four cases resolved after the initiation of the Pilot Program to see the benefits of meeting the four prongs of the Pilot Program. The message could not be clearer.

Chapter 4
Key Energy

Background Facts and Allegations

August witnessed the conclusion of the Key Energy, Inc. (Key Energy) FCPA enforcement action, which concluded with the filing of a cease and desist order (Order) in an SEC administrative proceeding. Key Energy had previously announced it had received a declination to prosecute from the DOJ in an April 8K filing, which read, "Key has been informed by the Department of Justice that the Department has closed its investigation and that it has decided to decline prosecution of the Company." The Order reported that Key Energy agreed to profit disgorgement of $5 million.

These basic facts lead the compliance practitioner to several interesting lessons learned from the FCPA enforcement action, each of which can be used to improve a compliance program and inform the necessary steps should your company find itself in an FCPA investigation. Additionally, the case has implications for other companies and industries that now find themselves in an economic downturn, such as the energy industry, because while the amounts of profit Key Energy obtained through bribery and corruption were not insignificant, the Order noted, "On September 4, 2015, Key Energy announced that for 30 consecutive trading days the price for Key's common shares was below the minimum $1.00 per share requirement for continued listing on the NYSE. Key Energy's common shares have continued to trade below $1.00 since that time. Between December 2014 and October 2015, Moody's downgraded Key Energy's bonds three times and changed its outlook to 'negative.'"

The corruption was in the company's Mexican subsidiary, which "consisted of Key Energy Services de Mexico S. de R.L. de C.V., and a service payroll company, Recursos Omega S. de R.L. de C.V., which is the legal employer of Key Energy's employees in Mexico," collectively referred to as "Key

Mexico" in the Order. Key Mexico made illegal payments to an "employee at Petróleos Mexicanos (Pemex), the Mexican state-owned oil company, to induce him to provide Pemex inside information as well as advice and assistance on contracts with Pemex and amplifications or amendments to those contracts." These payments were funded through an unnamed consulting firm.

The corruption scheme was also interesting in that Key Mexico was paying for insider information, made available earlier than public announcements, in addition to using the consulting firm for "influence." With the exception of four payments totaling $6,400, there was no evidence presented of either direct payments from Key Mexico to Pemex employees for contracts or even payment amounts through the third-party consulting firm. Finally, Key Mexico apparently used the consulting firm to increase components to contracts "through a series of amendments of 'amplifications,'" one of which was a $60 million increase in contract value.

Key Mexico hired the consulting firm in 2010. The firm was not subjected to the company's requirement for due diligence. The Mexico country manager never disclosed to Key Energy that the "Consulting Firm had ties to the Pemex employee and that payments to the Consulting Firm were used to funnel Key Mexico funds to the Pemex employee in exchange for his assistance with obtaining Pemex business." Lastly, this entire arrangement was not even reduced to writing in a contract.

All of the nefarious actions by Key Mexico did not absolve Key Energy of its responsibilities under the company's anti-corruption compliance program. At some point, the Key Energy legal department became aware of the relationship, yet allowed it to continue and indeed flourish. The Order stated, "Although the consulting arrangement with the Consulting Firm violated Key Energy compliance policies because it had been entered without pre-approval from Key Energy legal, because no due diligence had been conducted on the Consulting Firm and because no written contract had been entered with the firm, Key Energy allowed the relationship and payments to continue, and Key Mexico allowed payment of the invoices from the Consulting Firm despite a lack of sufficient documentation supporting the purported services and the ties between the Consulting Firm and the Pemex employee."

The consulting firm sent Key Mexico emails with attachments that included, "Pemex internal memoranda concerning certain new contracts that Pemex intended to put out for tender." There were also emails referenced in the Order "which contained detail of internal Pemex deliberations." This information was forwarded from Key Mexico to the U.S. corporate headquarters, "but the recipients at Key Energy apparently did not question how or why the country manager was in possession of and sharing such communications."

Moreover (and rather amazingly), the Key Energy Senior Vice President (VP) immediately sought a contract uplift of $90 million. This was communicated back down the line into Key Mexico and, as the Order stated, "One week later, on February 23, the Pemex employee, again from his Pemex e-mail account, forwarded the Key Mexico country manager an unexecuted internal Pemex memo, under which Pemex personnel recommended an increase of $60 million to the funds available to pay Key Mexico under Contract No. 8861. The Pemex employee wrote in the cover e-mail to the country manager: 'I am sending this to you so you can see I am working.' On March 24, 2011, a little more than a month later, Key Mexico and Pemex executed an amendment to Contract No. 8861 increasing the contract amount by approximately an additional $60 million." [emphasis added]

The consulting firm was rewarded handsomely for its efforts; "Between August 16, 2010 and May 7, 2014, Key Mexico made 58 payments to the Consulting Firm totaling approximately $561,000. Of that amount, at least $229,000 were payments made through April 2013 in connection with consulting services that were described in Key Mexico's accounting system as 'Expert advice on contracts with the new regulations of Pemex/Preparation of technical and economic proposals/Contract Execution.'" Additionally, and for reasons not made clear in the Order, the Key Mexico country manager also made four direct wire transfers from his personal bank account into the personal bank account of Pemex official who awarded the contract and uplifts to Key Mexico. These four payments totaled $6,400.

During the Investigation

The vast majority of the corrupt payments were made through a consulting firm, which had close connections with a Pemex official, who had decision-making authority over Key Mexico contracts. The consulting firm

apparently did not have a written contract with the company, the contract was not approved by the Key Energy legal department and did not go through any background due diligence, even though both were required under the Key Energy compliance program in place at the time of the issues involved. Even more amazingly is that when these issues became known to the corporate headquarters of Key Energy, the third party was allowed to continue.

Yet even without the minimum of any enforcement of a contract management process or third-party risk management process, Key Energy also failed in having a set of internal controls around payments. The Order noted that out of the $561,000 in payments made to the consulting firm, "at least $229,000 were payments made through April 2013 in connection with consulting services that were described in Key Mexico's accounting system as 'Expert advice on contracts with the new regulations of Pemex/Preparation of technical and economic proposals/Contract Execution.'" Such description of services is a clear red flag, which should always warrant additional investigation.

While Key Energy had a compliance program in place, it certainly did not engage in compliance.

While Key Energy had a compliance program in place, it certainly did not engage in doing compliance. The corporate offices failed in the basic oversight of Key Mexico around compliance and did not monitor compliance in Mexico to "ensure they complied with and enforced anti-corruption policies and kept accurate records concerning payments to consultants and gifts to Mexican government officials." Additionally, there was no oversight or monitoring by compliance or internal audit, who could enforce the requirements of the company's anti-corruption compliance program or even clean up the mess with remedial actions.

Finally, there was one paragraph in the Order which demonstrated Key Energy's complete failure of internal controls. More importantly, the SEC laid out in this same paragraph how the information about the violation could have been used by the company to stop the illegal conduct. In short, the Order describes how transaction monitoring can be used on a case-by-case basis to detect and remediate illegal conduct and prevent it going forward. The specific issue was around monies made as a donation for a Christmas

raffle intended to benefit Pemex employees.

No doubt there will be commentators who will use this paragraph to claim that money or gifts donated for customer raffles violates the FCPA. Such views miss the entire point of this paragraph. The Order stated, "in 2012, Key Energy approved Key Mexico's contribution of gifts totaling approximately $118,000 to Pemex's annual Christmas season celebration with the understanding that the gifts were to be intended for a raffle." However, of this amount, some $55,000 was designated to 130 specific Pemex officials, not a general donation for the benefit of all Pemex employees.

The Order went on to specify that the amount was nine times greater than the amount donated for the Christmas raffle for Pemex employees in 2010 and some 26 times the amount spent in 2011 for the same event. More interestingly, the SEC pointed out "Key Energy also failed to consider the implications of the explanation by Key Mexico's country manager that the higher gift amount in 2012 was correlated to Key Mexico having done more business with Pemex that year." If Key Energy had engaged in such transaction monitoring, it would have seen an increase in business with Pemex, which, of course, could then have been further investigated. As the Order noted, "Had Key Energy sought more information, it may have learned that Key Mexico was providing gifts to Pemex officials during a period Key Mexico was engaged in ongoing negotiations with Pemex, including negotiations to obtain additional funding for work required under its contracts with Pemex."

This transaction monitoring analysis laid out by the SEC in its Order clearly intones the SEC will be expecting this type of monitoring going forward. This means a Chief Compliance Officer or compliance function will need visibility into not only gifts, travel, entertainment and donation spends in high-risk areas, but also sales information so they can be correlated and reviewed from the compliance perspective. This is a new level of detail we have not seen before.

The Comeback

By any stretch, Key Energy obtained an excellent result from its FCPA journey. The company received a declination to prosecute from the DOJ, and its only financial penalty was a $5 million disgorgement Order from the SEC.

The company remediated so thoroughly that it did not require a monitor going forward. All of this means that the Key Energy FCPA enforcement action should be studied by compliance professionals to determine how Key Energy obtained these positive results.

It is essential to note that this result was achieved even though Key Energy did not self-disclose to the DOJ or SEC. The Order reports that the SEC contacted Key Energy in January 2014 "with respect to potential FCPA violations." In April 2014, "Key Mexico employees reported to Key Energy information they had received suggesting the recently resigned country manager had promised bribes to one or more Pemex employees during his employment with Key Mexico." At that point, Key Energy reported these allegations to the SEC and the company undertook a "broad internal investigation and risk assessment of Key Energy's international operations."

However, from that point forward, it appears that the cooperation afforded by Key Energy to the SEC was exemplary, as "To the extent the internal investigation identified additional issues of concern, Key Energy provided updates to the Commission staff." Key Energy provided translated documents to the SEC and provided overall cooperation to the SEC, all of which "assisted the staff in its investigation."

Key Energy also engaged in extensive remediation to its compliance program after it was notified by the SEC. Initially, the company hired a new Chief Compliance Officer, who led an effort to make "significant remedial measures." As set out in the Order, the company accomplished the following during the pendency of the investigation. These measures included:

1. The suspension of payments to all vendors and third parties in Mexico shortly after the independent investigation/internal review began;
2. The engagement of a manual review of over 600 vendors in Mexico for purposes of clearing legitimate payments and assessing whether to move forward with those vendors in current and future operations;
3. Reviewing all vendors in use in Russia and Colombia and instituting an enhanced due diligence procedure for all vendors globally;
4. Establishing enhanced financial controls around the proce-

dure-to-pay process in Mexico, Colombia and Russia, including interim employee certification requirements, revised vendor onboarding requirements and heightened payment approval requirements;

5. Implementing a new business opportunities protocol to help Key Energy legal better understand business risks, including the role played by agents, consultants or other vendors/business partners, so as to enable better assessment of corruption-related risks in future business opportunities;
6. Installing new controllers in the Colombia and Mexico businesses and more effectively enforcing a solid line reporting relationship to the U.S. Controller and ultimately the CFO;
7. In-person visits to each international location by the CCO and others to, among other things, conduct training of all international employees; and
8. Developing and/or reviewing several company policies and procedures including the code of business conduct, the FCPA and anti-corruption policy, the travel and expense policy and the new hire screening form; and
9. A coordinated wind-down and exit of all markets outside of North America, and a commitment to exit Mexico by the end of 2016.

Initiatives one through three generally describe investigatory efforts; initiatives four and five are creation or enhancement of internal controls; initiative six speaks to appropriate business personnel to effect the doing of compliance; initiative seven relates to putting on in-person training and having a CCO who gets out of the corporate office and visits the employees in the field; initiative eight relates to updating and upgrading Hallmark Two of an effective compliance program as set out in the FCPA Guidance, including the company's code of conduct and written policy and procedures; and, finally, initiative nine demonstrates why a company should create an effective compliance program, as the company is moving away from all international markets, save Canada.

There is one other noteworthy component to this SEC resolution, and that is the disgorgement of $5 million. There is no other financial penalty listed. One must assume this is based upon the company's cooperation and remediation and its financial condition. Indeed, one paragraph of the Order

reads, "In determining to accept the Offer, the Commission considered cooperation Key Energy afforded to the Commission staff and the remedial acts undertaken by Key Energy. In addition, in determining the disgorgement amount and not to impose a penalty, the Commission has considered Key Energy's current financial condition and its ability to maintain necessary cash reserves to fund its operations and meet its liabilities." In a section entitled "Undertakings," the Order also specifies the actions the company will take if it is forced into or voluntarily goes into bankruptcy. Key Energy agreed to "undertake all reasonable efforts to obtain authorization from the bankruptcy court having jurisdiction over Respondent's bankruptcy to pay the disgorgement amount."

These final two provisions make clear that the SEC has no interest in putting a company out of business. But, more importantly, it recognizes modern business economic realities, including (but not limited to) the state of the energy industry, corporate debt and its attendant obligations, the unanticipated actions of creditors in forcing companies into involuntary bankruptcy, the maintenance of cash reserves and other factors as well. While there have been other FCPA resolutions that took into account a company's ability to pay when assessing the fine or penalty, the Key Energy resolution makes clear that the SEC understands and accepts the business realities on the ground.

This enforcement action presents clear evidence of what a company can do when it finds itself in the throes of an FCPA violation. While it is not clear if the same result would have been achieved before the advent of the Pilot Program, the company's declination received from the DOJ and the relatively modest overall penalty assessed by the SEC demonstrate that when a company shows its willingness to work with the DOJ and SEC in a manner which they have articulated, the government will actively reward such cooperation.

Chapter 5
AstraZeneca

The AstraZeneca PLC (AZN) enforcement action, resolved by a cease and desist order (Order) brought by the SEC, had several interesting factors, and – more significantly for the Chief Compliance Officer and compliance practitioner – a continuation of several lessons to be learned from enforcement actions over the past several months. While the conduct at issue occurred between 2005 and 2010 and has been seen in other anti-corruption enforcement actions, it remains useful to review the facts presented so that compliance professionals can test their compliance regime.

The company came to FCPA grief for its actions in its Chinese and Russian subsidiaries. In China, the subsidiary (AZ China) made numerous improper payments to health care providers (HCPs) "in the form of cash, gifts and other items … incentives to purchase or prescribe AZN pharmaceuticals." Sales and marketing team members, including managers within various business units at AZ China, designed and implemented the improper payment schemes. The HCPs who received the improper incentives worked for various government entities in several regions throughout China. Interestingly, the "AZ China sales staff and their managers maintained written charts and schedules that recorded the amount of forecasted or actual payments of maintenance fees, gifts, entertainment and other expenses that AZ China would make per month or year."

We also saw the re-emergence of our old Chinese corruption vehicle, the travel agency, which was featured so prominently in the GlaxoSmithKline (GSK) Chinese corruption case. These corrupt travel agencies would submit falsified or inflated invoices which in turn could be used to generate monies from the corporate home office to pay bribes. There were also speaker fees paid for speeches never made and travel bookings reimbursed for travel which never occurred, both of which were purloined through insufficient documentation and failures of internal controls.

In AZ's Russia subsidiary, (AZ Russia) the "employees provided improper incentives to government-employed HCPs in connection with sales of AZN pharmaceutical products. As was done by AZ China employees, AZ Russia

employees created and maintained charts tracking the names of HCPs, the regions in which they practiced, their level of influence in making purchasing decisions for the respective entities where they worked and the manner in which they could be motivated to purchase AZN products through gifts, conference support and other means."

Further instructiveness comes from the result achieved by AZN. For violations of both prongs of the accounting provisions of the FCPA: (1) books and records and (2) internal controls, the company sustained a civil penalty which was relatively low at $375,000; profit disgorgement of $4.3 million, which represents profits gained as a result of the conduct described in the Order and prejudgment interest of $822,000, for a total of approximately $5.5 million. Additionally, there was no external monitor required – all of this with no self-disclosure by AZN.

For the CCO or compliance practitioner, the actions engaged in to remediate its compliance program marked the measure of its result.

AZN engaged in extensive cooperation during the investigation and significant remediation. For its cooperation during the investigation, the company "immediately took a cooperative posture and ensured that it consistently provided complete information in a timely manner. AZN voluntarily and timely disclosed information obtained during its own internal investigation, provided translations of key documents and disclosed facts that the Commission would not have been able to readily and independently discover. AZN also kept the staff regularly informed of its ongoing remedial efforts throughout the course of the investigation."

For the CCO or compliance practitioner, the actions engaged in to remediate its compliance program marked the measure of its result. The Order noted that the company:

- Incorporated information developed in the course of the Commission's investigation to further enhance its controls and compliance program;
- Made significant increases to both capital and human resources available to compliance at the corporate level and in the local markets;

- Developed a centralized compliance program;
- Revamped its internal controls and procedures;
- Placed key compliance personnel in high-risk markets;
- Enhanced anti-corruption training and company audits of its compliance program; and
- Provided targeted training and discipline to any company employee involved.

Additional compliance program improvements included:

- enhancements to AZN's policies governing interactions with HCPs and government officials;
- gifts, travel and entertainment;
- third-party engagements; and
- meetings, congresses and contributions.

This FCPA enforcement action continues the clear path laid out by the SEC from June 2016 forward. There will be civil enforcement of the FCPA where the company has not met the standards of the accounting provisions. However, even without self-disclosure, a company can receive a relatively low civil penalty if it cooperates during the investigation and engages in extensive remediation of its compliance program. The problem is this: if a company wants to go to court and fight the charges, it will most probably continue the same conduct that led to the original issue and will not have received credits going forward for its penalty, hence giving it greater liability.

Chapter 6
Johnson Controls

Background Facts

Next was the Johnson Controls, Inc. (JCI) FCPA enforcement action. Mike Volkov called the enforcement action a "head scratcher." Whether you agree with Volkov's analysis or not, the case has several significant points for the Chief Compliance Officer or compliance practitioner.

The matter was settled via a cease and desist order (Order) from the SEC and a declination issued by the DOJ. For its penalty, JCI accepted over $11.8 million in profits as a result of approximately $4.9 million in improper payments made by China Marine. JCI agreed to disgorge these profits, pay pre-judgment interest of $1.38 million and a civil penalty of $1.18 million, for a total amount of $14.36 million.

The underlying facts are about as sordid as they can be for a corporate enforcement action. JCI obtained the Chinese unit, China Marine, through its purchase of York International (York) in 2005. In 2007, York paid $22 million to the DOJ and SEC to resolve FCPA offenses in China and other countries that occurred between 2001 and 2006. York agreed to a three-year independent compliance monitor. JCI, for its part, terminated those involved in China Marine's illegal conduct after it acquired York.

JCI installed its own Managing Director and limited China Marine's use of third-party sales agents. However, as stated in the Order, "From 2007 to 2013, the managing director of China Marine, with the aid of approximately eighteen China Marine employees in three China Marine offices, continued the bribery and theft that began under his predecessor by using vendors instead of agents to facilitate the improper payments. The improper payments were made to employees of government-owned shipyards as well as ship-owners and unknown persons."

The bribery scheme was quite sophisticated. It involved "a multi-stepped arrangement that required the complicity of nearly the entire China Marine office from the managing director, to the sales managers, the procurement managers and finally to the finance manager. The managing director

aided or at times approved requests for the addition of certain vendors to the vendor master file without disclosing that certain sales managers had ownership or beneficial interest in the vendors. After the managing director's approval, sales managers added bogus costs for parts and services to sales reports, which inflated the overall cost of the project, and generated purchase orders for the bogus parts and services. The procurement manager knowingly approved the purchase orders." The scheme even included the vendors themselves, who "created fake order confirmations for the unnecessary parts and services and submitted invoices for payments." To complete the circle, the China Marine finance manager would authorize the fraudulent payments.

In what can only be called a complete, total and utter failure of JCI's internal controls, company auditors could not understand the China Marine transactions. Further, and with even more evidence of the lack of effective internal controls, many of China Marine's transactions were deemed non-material, so they were at a level below that which would trigger a review of corporate oversight from JCI's Denmark office, which oversaw the China Marine business unit. The Order noted that the average vendor payment in the bribery scheme "was approximately $3,400" but the total amount of bribes paid was $4.9 million. One might reasonably wonder if JCI understood there was no materiality threshold under the FCPA. One might also ask if there was conscious indifference by the JCI corporate office.

For the CCO or compliance practitioner, there are several important lessons to be garnered from this enforcement action. First is the absolute requirement for effective internal controls to be put in place. If your company does not understand the transactions a subsidiary engages in, you have put your company at serious risk; for if a company's internal auditors cannot understand a series of transactions, they certainly cannot explain them to an auditor. Further, under Sarbanes-Oxley (SOX) §404, a company must not only acknowledge its responsibility for establishing and maintaining a system of internal controls and procedures for financial reporting and an assessment, but also report on the effectiveness of the company's internal controls.

In "An Assessment of the Impact of the Sarbanes-Oxley Act on the Investigation Violations of the Foreign Corrupt Practices Act," Karen Cascini

and Alan DelFavero wrote, "Section 404 'requires management to annually disclose its assessment of the firm's internal control structure and procedures for financial reporting and include the corresponding opinions by the firm's auditor.' More particularly, 'while the FCPA required public companies to institute effective internal controls to stop the bribes and make executives accountable, SOX 404 goes further, but has similar goals.'"

All of this might reasonably lead one to ask: who at the corporate headquarters certified the effectiveness of both the JCI and China Marine's internal controls? Moreover, the accounting provisions of the FCPA also includes a section requiring accurate books and records. Clearly JCI was not too interested in verifying the accuracy of the books and records of its China Marine subsidiary.

More than this lack of compliance with both prongs of the FCPA accounting provisions, the seeming lack of awareness of enhanced risks is a confounding aspect of this case. China Marine was clearly identified as a high-risk business unit of both York and later JCI. Simply putting your self-appointed Managing Director in place is not enough. Any competent risk management system requires oversight, or as my wife would say, "a second set of eyes." This is why an effective compliance program requires ongoing monitoring. It is even truer when an entire business unit is high-risk.

The Declination

Next, consider the information available on the actions by JCI, beginning with the self-disclosure, which led to the DOJ granting a declination. The commentary on the DOJ declination has ranged from the FCPA Professor, who argued there was no viable cause of action against JCI for the illegal conduct of its subsidiary, China Marine (making the declination without substance), to Mike Volkov, who noted, "there appears to be plenty of justification to stretch here in this case when you basically have a recidivist continuing to violate the law," in arguing there were potential criminal charges to pursue. I want to consider the matter from the angle of the new DOJ Pilot Program and see what, if anything, might be gleaned from that perspective.

One of the difficulties in evaluating any declination is the paucity of facts available to the compliance practitioner to evaluate. In the JCI case, we have the SEC resolution via a cease and desist order that lays out the facts relevant to that enforcement action. However, this Order is the product of negotiations between the SEC and JCI. This means the company can seek to keep out facts that would point to criminal liability, reputational damage, embarrassing senior executives or a plethora of other issues the company does not want in the public domain. There is no way to know if the facts laid out in the Order are all the facts in the case that were known to the DOJ or even disclosed to the DOJ, so to base an argument on this underlying premise puts you on wobbly ground. The foregoing is one of the reasons I have argued for my information to be made public around declinations, as there is some basis for the self-disclosure by JCI to the DOJ.

One of the difficulties in evaluating any declination is the paucity of facts available to the compliance practitioner to evaluate.

Yet, even if one took the facts presented in the Order as the only facts of this matter, there is information that could lead one to reasonably conclude that criminal charges could be considered under the FCPA. The accounting provisions, both books and records and internal controls, are generally thought to be civil-side requirements only. However, the statute does make violations of the accounting provisions under the following:
"(4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection except as pro¬vided in paragraph (5) of this subsection.
(5) No person shall knowingly circumvent or knowingly fail to imple¬ment a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2)."

Paragraph 2 refers to the internal controls requirements of the FCPA. This means someone must knowingly falsify such records or fail to implement a system of internal controls. The facts laid out in the Order would appear to provide at least an argument that this threshold was met. JCI's internal controls were so poor that the company "did not understand some of the highly customized transactions at China Marine or the projects involving the sham vendors." Additionally, someone at the corporate office had to certify that the financial statements were true and correct, and whoever

did could also have violated the FCPA. Volkov noted that the DOJ could "stretch" to bring criminal charges, but either through the argument of conscious indifference or simply on the facts laid out in the Order, I find an argument for criminal liability plausible. Of course, these arguments do not convict JCI of criminal violation of the FCPA – only a trier of fact can do so – yet they make clear that there are credible arguments which could be pursued, making a declination an appropriate mechanism for the DOJ to use at its discretion.

What led the DOJ to exercise its discretion in issuing the declination? We can find some guidance from the four requirements under the Pilot Program. First, that there be self-disclosure, which was present in this matter. The Order stated that the company self-disclosed within one month after receiving a second anonymous whistleblower tip. Second is cooperation during the investigation. The Order stated that JCI provided "thorough, complete and timely cooperation," which consisted of the following:

- JCI promptly and routinely provided the staff with the results of its investigation as it progressed and provided all supporting documentation requested.
- JCI provided factual chronologies, hot document binders and interview summaries, as well as English translations of numerous documents and emails.
- JCI made employees available for interviews.
- JCI provided real-time downloads of employee interviews and made other foreign employees available for interview.
- When the company caught a Chinese employee shredding documents, it quickly secured the office to preserve evidence.
- JCI's cooperation assisted the staff's investigation.
- JCI's timely self-reporting and the thorough productions allowed the staff to initiate and complete its investigation quickly.

The next requirement under the Pilot Program is for extensive remediation during the pendency of the investigation. Here, the Order laid out some of the steps taken by JCI, including:

- JCI terminated or separated 16 employees implicated in or associated

with the illegal scheme and placed all suspect vendors on a do-not-use/do-not-pay list.

- JCI has closed down its China Marine offices and moved all remaining China Marine employees, none of whom perform a sales or procurement function, into existing offices.
- JCI enhanced its integrity testing and internal audits to re-evaluate vendor onboarding for all JCI business worldwide.
- JCI implemented random site audits to ensure the delivery of goods on purchase orders.

The final requirement under the Pilot Program is that the company disgorges profits it received from its ill-gotten gains. The Order said, “From 2007 to 2013, JCI obtained a benefit of $11.8 million as a result of over $4.9 million in improper payments made to or through approximately 11 problematic vendors for the purpose of foreign and commercial bribery and embezzlement.” This corresponds to the amount paid as disgorgement.

For any CCO or compliance practitioner reviewing the JCI enforcement action, it does not matter whether you believe JCI committed criminal acts or not. The reality is that the DOJ is once again outlining conduct it will consider in order to award the lowest sanction possible: a declination. There have now been three declinations given since the announcement of the Pilot Program in April. You should study each of these and if you find yourself in an FCPA investigation, use each declination as a roadmap for your actions during the pendency of the investigation.

Chapter 7
The XYZ Deferred Prosecution Agreement in the UK

July also saw the U.K. Serious Fraud Office (SFO) obtain another court approval for a deferred prosecution agreement. I take a slight detour across the pond to visit the recent DPA awarded in the U.K. Crown Court at Southwark, entitled Redacted Approved Judgment (Judgment), in the matter of an unnamed company, designated as "XYZ Limited" (XYZ). The Judgment was issued on July 8, 2016.

The Court noted the income and eventual profits to XYZ; the Judgment stated, "taken together, in the period 2004-2013, a total of £17.24 million was paid to XYZ on the 28 implicated contracts on which bribes were offered. This sum represented 15.81 percent of the total turnover of XYZ in the period (being £109 million). The total gross profit from the implicated contracts amounted to £6,553,085 out of a total gross profit of £31.4 million (i.e., 20.82 percent). XYZ estimates a net profit of approximately £2.5 million in respect of the implicated contracts."

XYZ's U.S. parent, ABC Corporation, implemented a corporate compliance program in 2011 and it was during this initial implementation period that the bribery scheme was discovered. Subsequently, XYZ self-disclosed the illegal conduct to the SFO. The company turned over its internal investigation in 2013 and then the SFO conducted its own investigation until 2016.

The Court went through a very detailed analysis about why it should accept a DPA and reduced fine and penalty in a section entitled "The Interests of Justice." There were several factors laid out that are rather atypical in the DOJ's DPA program, even under the Pilot Program. While noting the seriousness of XYZ's conduct and the length of time the bribery scheme was employed, the Court put some amount of weight into the fact that it was in large part the agents and third parties who suggested the bribery scheme, and not the company. Here the Court wrote, "there is no question but that XYZ spiraled into criminality as a result of the conduct of a small number of senior executives bending to the will of agents." The Court also noted the change in XYZ's culture by stating, "It is clear that XYZ in its current form is effectively a different entity from that which committed the offence."

XYZ was assessed a financial penalty of £352,000, together with a disgorgement of profits at the amount of £6.2 million (£1.9 million to be paid by the American parent). The disgorgement amount will be paid over five years. The Judgment specifically took into account the ability of XYZ to pay the financial penalty as one of the factors that led to the Court accepting this amount. The length of the DPA was set to be "until the earlier of 31 December 2020, or such time after 31 December 2018 but before 31 December 2020, as the financial terms have been fully met."

Laura Dunseath, writing in a blog on thebriberyact.com entitled "Opinion: SFO's second DPA – A moderate step in the right direction. Could do better," felt "The XYZ DPA has achieved a very welcome step back in the right direction, but it still does not go far enough to truly accomplish the Government's stated aims of incentivizing companies to self-report and cooperate with the authorities." However, for any U.S. practitioner who negotiates a DPA, the Court oversight in the U.K. is very different. The Court's lengthy recitation of the facts, the law, the negotiations and even the Court's own questioning of the parties and their counsel demonstrates a level of judicial oversight not seen on this side of the pond.

Dunseath is concerned that there are not enough incentives under the SFO interpretation of the Bribery Act penalties to fully encourage companies to come forward and self-report. Her concern was based upon the prior DPA and a sentencing that she believed sent out mixed incentives to companies. Under the first U.K. DPA, involving Standard Bank, the fine was calculated using a multiplier of 300 percent from a range of 250 to 400 percent, and a discount of only 33 percent, which is on par with the discount usually applied to a guilty plea at the first opportunity. Next was the sentence involving the Sweett Group, in which the "financial penalty was proportionately lower since it was calculated using a 250 percent multiplier along with the 33 percent discount; and the proceeding against them were concluded at the sentencing hearing, and they are not subject to any ongoing conditions such as the monitoring of their compliance program or cooperation with ongoing proceedings."

She believed the SFO "sought to redress the balance and offer some advantage beyond the avoidance of criminal conviction" in the XYZ DPA, noting, "The fine was calculated using the 250 percent multiplier and a discount

of 50 percent was applied rather than 33 percent in recognition of the fact that further discount should be given when a defendant not only pleads guilty, but brought the matter to the attention of the authorities in the first place. The financial status of the company and the impact that the fine would have on its future ability to trade was fully considered, and the fine was accordingly reduced to prevent the company being forced into insolvency."

In an SFO press release, Director David Green said, "The decision as to whether to force a company into insolvency must be balanced with the level and nature of cooperation and this case provides a clear example to corporates." Further, comments from Green highlighted the differences between the DPA practice in the U.S. from that in the U.K. In the U.S., a DPA is a private agreement between the parties, and a court has no legal basis to do anything other than rubber stamp a DPA presented to it. In its statement, the SFO noted, "A DPA is not a private plea 'deal' or 'bargain' between the prosecutor and the company. It is a way in which a company accounts for its alleged offending to a criminal court, and can have no effect until a judge confirms in open court that the DPA is in the interests of justice and that its terms are fair, reasonable and proportionate."

A DPA is not a private plea 'deal' or 'bargain' between the prosecutor and the company.

I find the last statement to accent the most significant difference between the U.K. and U.S. practice with regard to DPAs. In the U.S., it is a private agreement, negotiated between the parties with no judicial input. In the U.K., there is not only judicial oversight, but also, more importantly, judicial input. While I recognize the Second Circuit here in the U.S. has made clear that charging decisions are within the sole discretion of prosecutors, this level of judicial oversight and review go a long way toward ensuring justice is accomplished in the U.K.

Chapter 8
Six-Month Pilot Program Wrap Up

I end this exploration of 2016's summer of FCPA enforcement (and one U.K. Bribery Act enforcement matter) by considering the three enforcement actions, all of which have resulted in the companies receiving a declination to prosecute from the DOJ. I present these declinations to help inform and assist compliance practitioners in guiding their own responses, should their companies become embroiled in FCPA investigations and attendant enforcement actions.

The enforcement actions involved Nortek, Akamai and Johnson Controls. Nortek and Akamai received NPAs from the SEC and declinations from the DOJ. JCI received a civil cease and desist order from the SEC and a declination from the DOJ. One other matter was resolved with the DOJ via an NPA, that being Analogic Corporation. Key Energy received a declination from the DOJ as well in May. However, the declination was not made public, so it is not discussed herein.

The Declination Letters

The letters issued by the DOJ did not provide a plethora of detail. The Akamai and Nortek declination letters were identical with the exception of the different corporate names. In relevant parts they stated, "we have reached this conclusion … based on a number of factors, including, but not limited to the fact that Nortek's internal audit function identified the misconduct, Nortek's prompt voluntary self-disclosure, the thorough investigation undertaken by the Company, its fulsome cooperation in this matter (including by identifying all individuals involved in or responsible for the misconduct and by providing all facts relating to that misconduct to the Department) and its agreement to continue to cooperate in any ongoing investigations of individuals, the steps that the Company has taken to enhance its compliance program and its internal accounting controls, the Company's full remediation…" The declination went on to add that the company had agreed to profit disgorgement.

The JCI letter stated, "We have reached this decision based on a number of factors, including but not limited to: the voluntary self-disclosure of the

matter by JCI; the thorough investigation undertaken by the Company; the Company's full cooperation in this matter (including its provision of all known relevant facts about the individuals involved in or responsible for the misconduct) and its agreement to continue to cooperate in any ongoing investigations of individuals; the steps that the Company has taken and continues to take to enhance its compliance program and its internal accounting controls; the Company's full remediation…" As with the Nortek and Akamai, the JCI letter also noted that the company had agreed to disgorge its profits.

About the only difference I can ascertain in the letters is that Nortek and Akamai provide "fulsome" cooperation, and JCI provided "full" cooperation. Yet, the overall point of these declinations seems to be that the cooperation was very substantial.

Contrast the triple declination language with the NPA Analogic received, which specifically noted the company's lack of full cooperation. It stated, "the Company did not receive full cooperation credit because, in the view of the Offices, the Company's cooperation subsequent to its self-disclosure did not include disclosure of all relevant facts that it learned during the course of its internal investigation; specifically, the Company did not disclose information that was known to the Company and Analogic about the identities of a number of the state-owned entity end users of the Company's products, and about certain statements given by employees in the course of the internal investigation."

All parties admitted to facts, which could have formed the basis of a criminal FCPA enforcement action brought by the DOJ, yet they all received declinations. While it would certainly have been more helpful to have a full release of information by the DOJ, to assist the compliance practitioner in understanding the totality of the facts considered, these three declinations may well mark a new starting point in criminal FCPA enforcement going forward. Since at least 2014, with the Parker Drilling and Hewlett-Packard FCPA enforcement actions, the DOJ has provided significant credit to companies who thoroughly cooperated and provided extensive remediation during the pendency of their enforcement actions. With the Pilot Program implementation, these shifts are now official DOJ policy.

One other point unrelated to the Pilot Program discussion is the length of time in which the Akamai and Nortek matters were concluded: less than 18 months for both. This short time frame for a resolution is certainly a welcome development and shows that if a company comes forward quickly, is efficient in its investigation and proactive in its remediation, it can benefit with lower overall investigation and remediation costs as well.

Box Score Summary of Declinations

Pilot Program Factor	Akamai	Nortek	JCI
Self-Disclosure	Yes - before completing internal investigation	Yes	Yes - one month after it received a second anonymous complaint
Cooperation During Investigation	1. Sharing investigation 2. Identify and present relevant documents 3. Timely updates 4. Updates on remedial measures 5. Translating documents 6. Making witnesses available	1. Sharing investigation 2. Timely updates 3. Segregation and organization of documents 4. Translation of documents 5. Making witnesses available 6. Conducting risk assessment	1. Real-time updates, interview summaries and all requested documents 2. Yates binders including hot docs, interview summaries, chronologies and emails 3. Preservation of evidence
Remediation	1. Termination of culpable employees 2. Revision of internal audit testing and protocol 3. Strengthening of policies 4. Creation of compliance committee 5. Institution of mandatory compliance training 6. Modify auditing schedule to risk-based approach	1. Due diligence program for third parties 2. Strengthen compliance policies 3. Enhance compliance function, name CCO 4. Institution of mandatory compliance training 5. Enhance travel and expense controls in China	1. Termination of culpable employees 2. Suspension of culpable third parties 3. Incorporation of culpable China office into existing corporate structure 4. Enhanced integrity testing and auditing, including random audits 5. Random testing of transactions
Profit Disgorgement	Yes	Yes	Yes

Conclusion

The more I have read and reread these enforcement actions, the more I have come to believe they are hugely significant and need to be studied by each and every Chief Compliance Officer and compliance practitioner whose company is subject to the FCPA, because we may well have reached a turning point in FCPA enforcement and how companies evaluate potential FCPA claims and disclosure.

Here's why I think we may have reached this stage: previously, in the fact pattern presented by Nortek, Akamai, Johnson Controls and Key Energy, a company may have made the decision to investigate thoroughly, remediate effectively and then not self-disclose to the government. However, these enforcement actions, coupled with the Pilot Program, may change this calculus.

Of significant note was the length of time from initial discovery to self-disclosure to the final resolution in the Nortek and Akamai enforcement actions. Both were resolved quickly and efficiently. Nortek self-disclosed this matter in January 2015 and Akamai self-disclosed to the government in February 2015, and both had resolutions in June 2016. This is a very short time frame for resolution of an FCPA matter, and hopefully it will be a harbinger of things to come in terms of the reduced time frame from self-disclosure to resolution. Further, the reported investigation costs were far below those usually seen in FCPA investigations and enforcement actions.

Nortek's self-disclosure was based on the company's 2014 audit, which had identified potential issues in a routine audit of the China subsidiary. These concerns were elevated for a full FCPA forensic audit, and that investigation provided the information for the self-disclosure. Akamai began its investigation after a whistleblower report in December 2014. Both cases then show a less-than-two-year period from initial discovery to conclusion. This speaks to the robust nature of their "detect" prongs; either through Nortek's internal audit or Akamai's whistleblower program and response.

With the stated credit available in the Pilot Program and now the language from the DOJ in its declination and from the SEC in the two NPAs, I think companies may now see the benefits of coming forward and self-disclosing. Any company that makes the decision to not self-disclose most probably

investigated and remediated, so those costs will be incurring under such a scenario. However, companies may now see the benefit of such self-disclosure, both in terms of not only a positive result, but also a quick and efficient process. I would also note that the straight line from the Yates Memo to the hiring of the new DOJ Compliance Counsel, Hui Chen, to the Pilot Program may need to be extended to these two enforcement actions to demonstrate the change in the DOJ enforcement strategy.

However, there is more to be learned from these enforcement actions than simply the fact that it may now be better to self-disclose than to choose not to do so after complete investigation and full remediation. There were nuts and bolts nuggets about what to look for in your internal investigations. Indeed, there were a couple of compelling references made not often seen in FCPA investigations reports. First, in the Akamai internal investigation, its NPA reported that as a part of the company investigation, it provided to the government "analyses of customer usage versus purchased capacities." This is the type of data analysis we rarely see discussed in FCPA compliance programs, but that can greatly assist a CCO in looking at a large amount of information to see what risks strategically need to be investigated. Yet typically how many compliance practitioners either make this type of analysis or even have the capability to do so? This is why data analytics can be of use to the CCO going forward and, indeed, may be one of the prime ways to help the compliance function in terms of detection. Moreover, if such an analysis is used proactively, as a monitoring tool on an ongoing basis, it could move the needle from "detect" to "prevent." This is well worth considering as you think about your compliance budget and resources going forward.

The second investigative prong reference I found interesting was in Nortek's investigation protocol, which stated that the company conducted "a risk assessment to determine whether the improper conduct at Linear China occurred at Nortek's other manufacturing locations in China." Note that the government did not say Nortek performed a full FCPA forensic audit at the company's other manufacturing locations in China, but only a risk assessment. If there was ever language to validate the concept that a company does not have to "boil the ocean" in the context of an internal FCPA investigation, I think this statement may be it. If you move forward with a well-thought-out process, in a step-by-step approach, you do not need to look everywhere, for everything, under every rock.

I hope that you will study these enforcement actions closely – most particularly the NPAs and declinations – to see what lessons you may find for your compliance program. I also hope they will herald what's to come in both DOJ and SEC enforcements, where companies not only receive credit for turning over information on individuals for the government to prosecute, but for taking steps to engage in the doing of compliance and not simply having a paper compliance program in place. No matter what the reason for the timing of these settlement resolutions, they are a welcome development for the FCPA compliance practitioner.

The DOJ Pilot Program has come out of the box with some solid wins for the companies involved, the DOJ and the greater compliance community. If this pattern continues, it will allow the DOJ to focus its resources in driving home the message that it is doing compliance that will not only work to keep a company out of trouble, but will also get a company out of trouble.

Just as February 2016 was a month for the books in terms of the raw numbers of FCPA enforcement actions announced, the Summer of 2016 was one for the books in the change in enforcement. You would do well to take heed.

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