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PAUL HASTINGS

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Quarterly FCPA Report: Second Quarter 2011

Courtroom Activity Defines the Second Quarter of 2011

BY THE GLOBAL COMPLIANCE AND DISPUTES PRACTICE

I. INTRODUCTION

The second quarter of 2011 was an action packed three months for the Foreign Corrupt Practices Act ("FCPA"), which included judicial opinions, jury verdicts, and a Congressional hearing. In the Control Components Inc.[1] and Lindsey trials,[2] defendants challenged the definition of "foreign official" under the FCPA, and in both cases, the government's interpretation was upheld.[3] There were also rulings entered in the twenty-two defendant arms contract case.[4] There, the judge ruled that no actual foreign official is necessary to establish the element of intent under the FCPA and denied defendants' motion to dismiss, which had challenged the government's tactic of having an undercover FBI agent pose as an agent of an African country in order to solicit illicit payments from the defendants. Also in that case, the judge threw out one of the government's charges against U.K. citizen and defendant, Pankesh Patel, based on a lack of jurisdiction.

While the courts were active determining the perimeters of the current law, Congressional representatives held a hearing to discuss possible amendments to the FCPA. On June 14, 2011, the House Judiciary Committee's Subcommittee on Crime, Terrorism and Homeland Security held a hearing on the FCPA. During this hearing, various amendments to the law were discussed, including: 1) clarifying the definition of "foreign official" and "instrumentality," 2) creating a compliance program affirmative defense, 3) implementing changes to successor liability, 4) implementing changes to the mens rea requirement for company-defendants, and 5) creating a de minimis exception. At the end of the hearing, subcommittee Chairman James Sensenbrenner announced that the committee will be drafting a bill to amend the FCPA.

In addition to these developments on the interpretations of the law, there were numerous enforcement actions against individuals and companies. The individual actions included four guilty pleas and two guilty jury verdicts for FCPA violations, and the trial of the first four defendants in the arms contract case ended in a mistrial after the jury was unable to reach a verdict. The corporate actions included one guilty jury verdict and one deferred prosecution agreement ("DPA"). Also, three entities entered into settlement agreements with the Securities and Exchange Commission ("SEC"), two of which also entered into a DPA or non-prosecution agreement ("NPA") with the Department of Justice ("DOJ"). A final corporate entity entered into the first ever DPA with the SEC, while also entering into an NPA with the DOJ.

II. ENFORCEMENT ACTIONS AGAINST INDIVIDUALS

A. Haim Geri – Arms Contract Case

On April 28, 2011, Haim Geri became the fourth defendant to plead guilty in the twenty-two defendant arms contract case. Geri was an executive at HighTech USA, a Florida-based company that serves as a sales agent for companies in the law enforcement and military products industries. He had been charged in a superseding indictment on April 19, 2010 and pleaded guilty to one count of conspiracy to violate the FCPA. In the plea agreement, the government suggested an eighteen to twenty-four month prison sentence.

The indictment alleged that between May and December of 2009, Geri and twenty-one other defendants participated in a conspiracy to make illegal payments to government officials in the countries of Gabon and Georgia in order to secure contracts to supply the countries with ammunition and body armor, among other products. The defendants allegedly agreed to pay a twenty-percent "commission" to a sales agent, who the defendants believed represented the minister of defense for the country of Gabon, and were allegedly told that half of the "commission" would be paid directly to the Gabon's Minister of Defense. In fact, the "agent" was an undercover FBI agent and the Defense Minister had no involvement in the investigation.

B. Flavio Ricotti - CCI

On April 28, 2011, Flavio Ricotti pleaded guilty to conspiring to violate the FCPA and the Travel Act. Ricotti is a former executive of Control Components Inc. ("CCI"), a California-based valve company. He was extradited to the United States in July 2010 after being arrested in Germany earlier that year. He faces up to five years in prison.

Ricotti admitted to conspiring with other CCI employees to make illegal payments to non-U.S. government officials in Saudi Arabia and officers and employees of private companies in Qatar. This included an official at Saudi Aramco, the Saudi Arabian state-owned oil company, and an employee at a Qatari private company.

CCI pleaded guilty in 2009 to conspiring to violate the FCPA and Travel Act and for violating the FCPA. CCI admitted to making unlawful payments in over thirty countries and was ordered to pay an $18.2 million fine, among other compliance requirements. Also in 2009, Mario Covino and Richard Morlok, former CCI employees, pleaded guilty to charges of violating the FCPA, while Ricotti and five other former CCI executives were charged for their roles in the scheme.

C. Arms Contract Case Defendants

On May 6, 2011, Judge Richard Leon, presiding over the twenty-two defendant arms contract case, ruled on a list of pretrial motions. Most notably, Judge Leon ruled that "an actual foreign official is not a necessary element" of the FCPA. Defendants had argued that because no foreign official was ever involved in the scheme, since the U.S. government had used law enforcement personnel posed as a government official, there could not be a violation. Judge Leon disagreed, ruling that as long as the defendants had a "firm belief" a foreign official would receive the unlawful payment, they could be in violation of the law.

On June 6, 2011, in the same case, Judge Leon ruled that defendant Pankesh Patel, a U.K. citizen, could not be charged with violating the FCPA for an act committed outside the United States. Judge Leon agreed with defense lawyers that mailing an allegedly corrupt agreement from London to Washington, D.C., was not an FCPA violation, because it originated outside the United States. As a result of the ruling, Judge Leon dismissed one FCPA count against Patel, though Patel was still tried for the remaining charges. Judge Leon's ruling in this regard could set precedent for future FCPA cases and limit enforcement authorities' reach.

In this case, the government separated the original twenty-two defendants into four groups to be tried separately. Trial opened on May 16, 2011 for the first group, which included defendants Pankesh Patel, John Benson Wier III, Andrew Bigelow, and Lee Tolleson. The trial ended in late June, and after five days of jury deliberation, the judge declared a mistrial on July 7, 2011, because the jurors were unable to reach a verdict.

D. Keith Lindsey, Steve Lee, Angela Aguilar, and Lindsey Manufacturing

On May 10, 2011, Lindsey Manufacturing and two of its executives, Keith Lindsey and Steve Lee, were convicted of conspiring to violate the FCPA and substantive FCPA violations, and Angela Aguilar, the wife of Lindsey's Mexican sales agent, was convicted of conspiracy to launder money. The defendants were charged with making unlawful payments to officials at Mexico's state-owned electric utility, Comisión Federal de Electricidad ("CFE"). The jury verdict came after only one day of deliberation and the Lindsey executives face a potential thirty-year prison sentence. Following the verdict, Aguilar entered into a plea agreement where she was sentenced to time served, probation, and her immediate return to Mexico in exchange for her agreeing not to contest the government's seizure of approximately $3 million in assets.

Lindsey Manufacturing makes emergency restoration systems and other equipment used by electrical utility companies. Between 2002 and 2009, Lindsey Manufacturing and its executives paid a thirty percent commission to its Mexican sales agents, Enrique and Angela Aguilar, for sales to CFE. The commission was paid with the understanding that it would be used to make illegal payments to CFE in exchange for contracts. To compensate for the extra cost of the unlawful payments, Lindsey Manufacturing raised the price of its contracts with CFE by thirty percent. The Aguilars were accused of using some of the money to buy a $1.8 million yacht and a $297,500 Ferrari for CFE officials and paying more than $170,000 worth of American Express bills and sending approximately $600,000 to a CFE official's relatives.

The defendants' convictions represent a significant victory for the DOJ, which was forced to defend its interpretation of the term "foreign official." The defendants argued vigorously that officials of foreign state-owned entities, like CFE, are not "foreign officials" under the FCPA. In denying defendants' motion to dismiss on April 1, 2011, Judge Matz found that, because CFE is an "instrumentality" of the Mexican Government, its officials are properly characterized as "foreign officials" for FCPA purposes.[5] The language in Judge Matz's written opinion is crafted narrowly, stating that he denied the motion because a state-owned entity "having the attributes of CFE *may* be an 'instrumentality.'" According to Judge Matz, factors to consider include:

- Whether the entity provides a service to the citizens of the jurisdiction;
- Whether the key officers and directors of the entity are, or are appointed by, government officials;
- Whether the entity is financed, at least in large measure, through governmental funds;
- Whether the entity possesses and exercises exclusive or controlling power; and
- Whether the entity is widely perceived and understood to be performing governmental functions.

Following the verdict, on May 27, 2011, counsel for the defendants discovered that the government neglected to hand over portions of the testimony of FBI agent Susan Guernsey from a grand jury transcript. District Judge Matz has postponed sentencing and will hold a hearing on September 8 to address whether the convictions should be dismissed because of the prosecutor's conduct.

E. CCI Defendants

On May 18, 2011, United States District Court Judge James Selna denied a motion to dismiss a DOJ indictment alleging that former CCI executives violated the FCPA.[6] Similar to the Lindsey case, the motion challenged the DOJ's interpretation of who qualifies as a "foreign official" under the FCPA.

The ten-count indictment charges Stuart Carson, his wife Hong "Rose" Carson, Paul Cosgrove, and David Edmonds with violating FCPA anti-bribery provisions. Specifically, it alleges that between 2003 and 2007, the defendants made close to $4.9 million in unlawful payments to officials of state-owned companies in China, Korea, Malaysia, and the United Arab Emirates. The indictment alleges that the defendants' illegal payments resulted in $46.5 million in profits for CCI.

On February 21, 2010, the defendants filed the motion to dismiss, disputing the DOJ's view that employees of state-owned entities are "foreign officials" under the FCPA. The motion argued that state-owned entities are not "instrumentalities" of a foreign government as defined by the FCPA.

The fundamental conclusion of Judge Selna's decision was that under the FCPA, determining whether a state-owned entity is an instrumentality is a "question of fact." Judge Selna listed a number of factors to be considered when deciding whether a business entity constitutes a government instrumentality, including:

- The foreign state's characterization of the entity and its employees;
- The foreign state's degree of control over the entity;
- The purpose of the entity's activities;
- The entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions;
- The circumstances surrounding the entity's creation; and
- The foreign state's extent of ownership of the entity, including the level of financial support by the state (e.g., subsidies, special tax treatment, and loans).

None of the factors is dispositive, and the list is not exhaustive. Their main purpose, according to Judge Selna, is to point out the relevant inquiries necessary to determine whether a state-owned company is an "instrumentality" under the FCPA. Judge Selna also rejected the defendants' proposition that "governmental and commercial actions are necessarily incompatible" – a point which defendants relied upon heavily. Trial for the CCI defendants is set for October 4, 2011.

F. Manuel Caceres and Jorge Granados - LatiNode

On May 18 and 19, 2011, Manual Caceres, former Vice President for Business Development of Latin Node, Inc. ("LatiNode"), and Jorge Granados, LatiNode's former CEO, pleaded guilty to charges of conspiring to violate the FCPA. They both face up to five years in prison and a $250,000 fine. Four LatiNode executives have now pleaded guilty to conspiracy to violate the FCPA.

According to the DOJ, in 2006 and 2007, LatiNode executives made illegal payments totaling over $500,000 to officials of Honduras' state-owned telecommunications company, Empresa Hondureña de Telecomunicaciones ("Hondutel"). These payments were made to obtain an interconnection agreement with Hondutel and for a reduction of the per-minute rate in the agreement. The LatiNode executives covered up the unlawful payments by laundering the money through subsidiaries in Guatemala and accounts in Honduras controlled by Honduran government officials. Granados confessed that he authorized the illegal payments, and his sentencing is scheduled for August 22. The date of Caceres's sentencing has not been released.

III. RECENT CORPORATE ENFORCEMENT ACTIONS

A. JGC Corporation

On April 6, 2011, the DOJ entered into a DPA with JGC Corporation related to charges of conspiracy and aiding and abetting violations of the FCPA. JGC is a Japanese engineering and construction company headquartered in Yokohama, Japan. JGC will pay a $218.8 million criminal penalty and will have an independent monitor for two years.

JGC's charges stemmed from its participation in the TSKJ joint venture's conspiracy to make unlawful payments to Nigerian government officials to obtain construction contracts worth $6 billion. The TSKJ joint venture was comprised of Technip S.A., Snamprogetti Netherlands B.V., Kellogg Brown & Root, Inc., and JGC. Between 1995 and 2004, TSKJ was awarded four contracts by Nigeria LNG Ltd. to build liquid natural gas facilities on Bonny Island Nigeria. Nigeria LNG is owned forty-nine percent by the Nigerian government.

JGC allegedly authorized the joint venture to hire two agents to make payments to Nigerian officials in order to obtain these contracts. TSKJ paid over $180 million to these two agents, allegedly intending for some of the payments to be passed on to Nigerian officials. One of the agents, Jeffrey Tesler, pleaded guilty last quarter to charges of violating the FCPA and agreed to forfeit $149 million.

JGC was the last of the four TSKJ members to settle charges with the U.S. government. In total, the joint venture members have paid over $1.5 billion in criminal and civil penalties. Also, KBR's former CEO, Albert "Jack" Stanley, UK agent Jeffrey Tesler, and Wojciech Chodan, former salesperson and consultant for the UK subsidiary of KBR, have all pleaded guilty to violating the FCPA for their actions relating to this matter.

B. Comverse Technology, Inc.

On April 6, 2011, Comverse Technology, Inc. ("CTI"), entered into an NPA with the DOJ and settled a case with the SEC. CTI is headquartered in New York City and provides software and software systems for communication and billing devices worldwide. CTI agreed to pay a $1.2 million criminal penalty for violating the FCPA and a $1.6 million civil penalty which includes a $1.25 million disgorgement and $358,000 in prejudgment interest.

In the NPA, CTI accepted responsibility for violating the books and records provisions of the FCPA. Between 2003 and 2005, employees and a third-party agent of Comverse Ltd., a wholly owned subsidiary of CTI based in Tel Aviv, Israel, made improper payments to OTE, a Greek telecommunications provider owned one-third by the Greek government, in order to obtain contracts worth $10 million in revenue and $1.2 million in profits. These payments totaled approximately $536,000 and were inaccurately characterized as legitimate agent commissions in the subsidiary's, books and records. The SEC also stated that CTI failed to devise and maintain a system of internal accounting controls to sufficiently ensure that all transactions were properly recorded. This included a lack of any policy requiring due diligence reviews of sales agents.

To make these payments, Comverse Ltd. employed a third-party agent to establish an offshore entity in Cyprus. Comverse Ltd. made payments to the offshore entity, and eighty-five percent of this money was funneled to Comverse Ltd.'s customers. Ultimately, the third-party agent provided no business development services. CTI conducted an internal investigation, which discovered these payments, and then voluntarily disclosed to the DOJ.

C. Johnson & Johnson

On April 8, 2011, Johnson & Johnson ("J&J") entered into a DPA with the DOJ and a consent decree with the SEC resolving criminal and civil liabilities for alleged violations of the FCPA by wholly owned subsidiaries in Greece, Poland and Romania as well as allegations relating to concerns with regard to the UN Oil for Food Program.[7] The government cited to J&J's voluntary disclosure, thorough internal investigation, cooperation with the U.S. Government, and substantial remedial measures in its decision not to require an independent monitor, as J&J will be allowed to self-monitor its compliance program. Also, the monetary penalties were twenty-five percent below the minimum range under the U.S. Federal Sentencing Guidelines. J&J agreed to pay $21.4 million under the DPA and $48.6 million in disgorgement of profits and prejudgment interest under its settlement with the SEC.

J&J is headquartered in New Brunswick, NJ and manufactures and sells medical devices, pharmaceuticals, and consumer health care products. Following an internal complaint in 2006, J&J conducted an internal investigation of its operations in Greece and voluntarily disclosed its findings to the DOJ and SEC.

D. Rockwell Automation, Inc.

On May 3, 2011, the SEC entered into a settlement agreement with Rockwell Automation, Inc. for violating the books and records and internal controls provisions of the FCPA. Rockwell will pay a disgorgement of $1,771,000, $590,091 in prejudgment interest, and a $400,000 civil penalty.

Rockwell is based in Milwaukee, Wisconsin and provides industrial automation products and services. The alleged violations involved a former Chinese subsidiary, Rockwell Automation Power Systems Ltd. The SEC alleged that between 2003 and 2006, employees of the subsidiary made $615,000 in payments to third-party intermediaries at the request of employees of Design Institutes, which were typically state-owned enterprises that can influence contract awards. Also, employees of the subsidiary provided $450,000 in travel and entertainment for employees of Design Institutes and other state-owned companies. This included trips to Germany, Australia, New York City, Washington, D.C., and Hawaii. These trips usually followed business-related travel funded by the Rockwell subsidiary, but the SEC claimed they had "no direct business component, other than the development of customer good will." Rockwell allegedly obtained $1.7 million in profits as a result of contracts from Chinese government-owned companies that were associated with payments to the Design Institutes.

Rockwell discovered these payments in 2006 and hired counsel to conduct an internal investigation. Rockwell then self-reported its findings to the government and cooperated with the SEC.

E. Tenaris S.A.

On May 17, 2011, Luxembourg-based Tenaris S.A., a pipeline manufacturer, resolved an FCPA enforcement action by entering into a DPA with the SEC. The agreement marks the SEC's first ever use of a DPA in any enforcement action. Tenaris also entered into a separate NPA with the DOJ.

Under the SEC's DPA, Tenaris agreed to pay $5.4 million in disgorgement and prejudgment interest. Tenaris will also pay a $3.5 million criminal penalty. Cooperation from Tenaris in conducting an internal investigation resulted in reduced penalties, according to the DOJ and the SEC.

The SEC and DOJ alleged that between 2006 and 2007 Tenaris paid an agent in Uzbekistan in order to receive bidding documents in connection with a pipeline project. According to the U.S. authorities, Tenaris employees were aware that part of the agent's commission would be offered to officials of OJSC O'ztashqineftgaz, an Uzbekistan state-owned oil and gas company. Some of the alleged payments were made via wire transfer from a bank account in New York. As a result of the unlawful payments, the SEC asserts that Tenaris was awarded contracts worth close to $5 million in profits.

Pursuant to the SEC's DPA, beginning in early 2012, Tenaris must review and update its code of conduct. High-level Tenaris employees must verify compliance with the code of conduct as soon as possible, and training must be provided to employees in management positions. Under the DOJ's NPA, Tenaris admitted responsibility for the illegal payments and agreed not to make any public statements denying the alleged conduct. Tenaris also admitted that it failed to keep accurate books and records that reflected the illegal payments to the agent.

IV. OTHER – ICE Victim Claim

On June 17, 2011, the U.S. Court of Appeals for the Eleventh Circuit denied a petition for mandamus that was filed by Costa Rica's Instituto Costarricense de Electricidad ("ICE"). ICE filed the petition following a district court's ruling to deny ICE victim status in an FCPA enforcement action. ICE, a provider of telecommunication services and electric power in Costa Rica, is the first foreign state-owned entity to assert victim status in an FCPA context.

ICE allocated over $300 million in contracts to Alcatel-Lucent ("Alcatel") after receiving unlawful payments from the Paris-based company. In December 2010, Alcatel agreed to pay a total of $137 million under its DPA with the DOJ and settlement with the SEC. In May 2011, ICE asked a federal court in Florida to prevent Alcatel's settlement, claiming that the agreement ran afoul of federal victims' rights law. Specifically, ICE complained that the agreement between the U.S. enforcement authorities and Alcatel did not provide for sanctions against the guilty ICE executives and that the agreement required the illegal proceeds to be paid to the U.S. government. Arguing under the Mandatory Victims Restitution Act and Criminal Victims' Rights Act, ICE asserted that it deserved restitution as a victim of a FCPA violation. ICE asked the court to reject Alcatel's DPA and declare it a victim of Alcatel's criminal conduct.

Even though ICE recognized that its own employees received illegal payments from Alcatel, ICE claimed it was a victim because the corrupt acts caused tremendous harm to the company. Central to ICE's argument was the assertion that the corrupt acts of a few executives should not make the entire company an active participant in the illegal scheme. ICE also alleged that it was never contacted by the DOJ or the SEC prior to the settlement and that it was never consulted regarding the gathering of facts or damage calculations.

In denying the petition, the Eleventh Circuit ruled that the district court did not clearly err in determining that ICE functioned as the offenders' coconspirator, not a crime victim, and that ICE failed to establish that it was directly and proximately harmed by the offenders' criminal conduct.

V. CONCLUSION

It has been an active quarter for enforcement of the FCPA. New investigative tactics used by enforcement agencies have withstood judicial scrutiny, as has a broad definition of "foreign official."

Though it remains to be seen whether Congress will act to narrow the reach of the FCPA, there is no indication that the DOJ or SEC intends to reduce FCPA enforcement efforts. Globally, enforcement also continues to expand. China's new anti-bribery law went into effect on May 1, the UK Bribery Act came into force on July 1, and in June, Canada saw its first plea deal under its Corruption of Foreign Public Officials Act relating to unlawful payments made by Niko Resources Ltd. to a Bangladeshi minister. The current enforcement environment in the United States and evidence of increased anti-corruption enforcement in other countries make it even more critical for all companies to ensure their practices and policies are designed to protect them against liability for violating the FCPA and other anti-corruption laws.

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[1] *U.S. v. Carson*, et al., No. 09-77 (C.D. Ca. 2009).
[2] *U.S. v. Noriega*, et al., No. 10-1031 (C.D. Ca. 2010).
[3] A Paul Hastings Client Alert discussing these cases can be found here.
[4] *U.S. v. Amaro Goncalves*, et al., No. 09-335 (D.D.C. 2010).
[5] Criminal Minutes – General, Order Denying Mot. Dismiss (April 1, 2011), *U.S. v. Noriega*, et al., No. 10-1031 (C.D. Ca. 2010).
[6] Criminal Minutes – General, Order Denying Mot. Dismiss (May 18, 2011), *U.S. v. Carson*, et al., No. 09-77 (C.D. Ca. 2009).
[7] In a related case, the UK's Serious Fraud Office obtained a Civil Recovery Order of £4.829 million against a UK-based subsidiary of J&J, DePuy International Limited, for conduct related to the sale of orthopedic products in Greece between 1998 and 2006.