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SEC Enters into First Deferred Prosecution Agreement: What It Means for Corporations Facing FCPA Charges

Contributed by Morgan A. Heavener and Elizabeth L. Norton, Paul, Hastings, Janofsky & Walker LLP

Introduction

On May 17, 2011, the Securities and Exchange Commission ("SEC" or "Commission") entered into its first ever Deferred Prosecution Agreement ("DPA") with Tenaris S.A., a Luxembourgish manufacturer and supplier of steel pipes for the oil and gas, energy, and mechanical industries.[1] The SEC alleged that Tenaris violated the Foreign Corrupt Practices Act ("FCPA") by paying bribes to Uzbekistani government officials during a bidding process to supply pipelines for transporting oil and natural gas. The DPA provided that any action against Tenaris would be deferred for a two-year period conditional on Tenaris undertaking certain remedial measures.[2] In a parallel settlement, the company entered into a non-prosecution agreement ("NPA") with the Department of Justice ("DOJ").[3]

The SEC announced last year that it would begin using DPAs and NPAs in an effort to foster greater cooperation by defendants.[4] The SEC may find the new agreements particularly useful in FCPA enforcement actions since the Commission typically requires that corporate defendants undertake significant remedial measures. Specifically, unlike a simple administrative order such as a cease and desist order, the new agreements allow the SEC to "defer prosecution" for a several-year period during which the SEC may monitor a company's remedial efforts. While the SEC may find the new agreements useful as an enforcement tool, it remains to be seen whether they provide additional incentives to corporate defendants to cooperate. Specifically, given the joint nature of FCPA investigations involving both the DOJ and SEC, it may not be immediately clear what additional advantage a company may find to cooperate with the SEC given existing incentives for cooperation in such joint investigations.

DPAs and NPAs: New Cooperation Tools for the SEC

In January 2010 the SEC announced that it had revised its enforcement manual to include more formal procedures through which individuals and companies can cooperate with the Commission in order to receive a lesser sanction.[5] The January 2010 press release that accompanied the new manual noted that the Commission's initiative would improve the "quality, quantity, and timeliness of information and assistance it receives" from individuals and companies in investigations and enforcement actions.[6] In announcing the SEC's new approach, Robert Khuzami, Director of the SEC's Division of Enforcement, stated "This is a potential game-changer for the Division of Enforcement. There is no substitute for the insiders' view into fraud and misconduct that only cooperating witnesses can provide." [7]

The enforcement manual notes the existence of a "spectrum" of tools available to the Staff to foster cooperation, including proffer agreements, cooperation agreements, NPAs, DPAs, and criminal immunity requests.[8] The manual repeats the principles first enunciated in 2001 in the Seaboard Report as an analytical framework for the SEC Staff in evaluating cooperation among public companies. Those principles are: self-policing prior to the alleged misconduct; self-reporting of the alleged misconduct when it is discovered; remediation; and cooperation with law enforcement.[9]

With respect to the SEC's use of DPAs and NPAs, the new enforcement manual notes that the SEC intends for: [10]

- DPAs to serve as formal written agreements in which the SEC agrees to forego an enforcement action provided the company or individual cooperates truthfully and fully, enters into a long-term tolling agreement, and complies with established requirements during the deferred prosecution period; and
- NPAs to serve as formal written agreements in which the SEC agrees not to pursue an enforcement action, provided the company or individual cooperates fully and truthfully in the SEC's investigation and complies with any requirements established by the NPA.

While the SEC's DPA and NPAs appear to have many similarities, one difference is the requirement that individuals or companies entering into a DPA agree to a long term tolling agreement, which is not a requirement for an NPA. Along the same lines, the enforcement manual notes that if the DPA is violated during the period of deferred prosecution, "the staff may recommend an enforcement action to the Commission . . . without limitation for the original misconduct as well as any additional misconduct."[11]

These differences with respect to the duration of the agreements, however, appear to be somewhat subtle. For instance, although the enforcement manual does not require a period of deferred prosecution with respect to an NPA, the manual notes that "if [an] NPA is violated, the staff retains its ability to recommend an enforcement action to the Commission against the individual or company without limitation."[12] Further, the one NPA that the SEC has announced to date under the new enforcement guidelines, Carter's Inc., which involved allegations of accounting fraud, specifically and indefinitely tolled the statute of limitations. The Carter's NPA further stated that Carter's agreed to "cooperate fully and truthfully . . . regardless of the time period in which the cooperation is required."[13] Thus, at least in that one instance, the Commission retained oversight over the respondent well beyond the agreement date.[14]

Unlike the DPAs that the DOJ has used with increasing frequency in recent years, both the SEC's DPAs and NPAs are not filed publicly with a court.[15] The SEC's stated intention is to use the new agreements to solicit cooperation from individuals or companies for whom a court filing may do substantial harm, believing that such individuals or companies are more likely to cooperate in return for a less severe sanction. The SEC has long had the ability to issue administrative orders, such as cease and desist orders, to individuals or companies in instances where the underlying conduct does not warrant filing a civil complaint in court. Like an administrative cease and desist order, an NPA or DPA do not require an admission of facts or guilt. Unlike an administrative order, the NPA or DPA appear to provide the Commission Staff with the ability to keep a matter open to ensure that remedial actions are taken. Thus, the NPA and DPA appear likely to serve in practice as an intermediate sanction whereby the SEC refrains from filing charges in court (requiring an admission by a defendant and approval by a judge) but retains leverage to bring further, more substantive charges against an individual or entity that does not adhere to agreed upon remedial measures. Indeed, in the FCPA context, the SEC has recently used cease and

desist orders in instances in which the underlying conduct has not warranted any enforcement action by the DOJ.[16] In those instances, the cease and desist orders have noted in general terms the companies' cooperation and remedial measures. However, the cease and desist orders do not require any ongoing reporting requirements to the SEC.

The Tenaris DPA

The Tenaris DPA alleges violations of the FCPA in the form of improper payments to Uzbekistani officials in 2006 and 2007. While bidding on contracts to supply pipelines for transporting oil and natural gas, Tenaris made the payments to gain access to competitors' confidential bids and then revised its own bids accordingly.[17] The SEC also alleges that Tenaris made almost $5 million in profits when it was ultimately awarded these contracts. Under the terms of the DPA, Tenaris must pay $5.4 million in disgorgement and prejudgment interest and undertake significant remedial efforts.[18]

The Tenaris settlement also involved an NPA with the DOJ under which Tenaris must pay an additional $3.5 million criminal penalty.[19] The fact that the settlement involved a DOJ action confirmed that the SEC is likely to use DPAs in instances in which the Commission (and the DOJ) determine that the underlying conduct is more serious than when the SEC issues a cease and desist order.[20]

Further, unlike a cease and desist order, the SEC's use of the DPA in the Tenaris disposition permitted the SEC to defer the prosecution pending a two-year period in which the company agreed to toll the statute of limitations for the two-year duration of the agreement and to undertake significant remedial efforts, including providing a written certification of compliance to the SEC between forty-five and sixty days before the end of the deferred prosecution period; requiring that "each director, officer, and management-level employee certify compliance with the [company's] Code of Conduct on an annual basis; and conducting anticorruption training for "all current officers and managers" as well as (among others) "all employees working in Finance, Accounting, Internal Audit, Sales, and Government Relations."[21]

SEC DPAs and NPAs in the Context of FCPA Settlements

Although the SEC announced these new enforcement tools over a year ago, Tenaris is the first company to enter into a DPA with the SEC. The Tenaris DPA is also the first time that the SEC has used any of the new agreements in the context of an FCPA settlement. While the SEC will undoubtedly find that the use of DPAs provides the Commission with additional flexibility, whether the agreements provide any additional incentive for corporate defendants to self-disclose FCPA issues and cooperate with the SEC remains to be seen. In the corporate context, the SEC's view is that certain companies may find that the prospect of avoiding a public filing and the possibility for reduced sanctions an incentive to self-disclose and cooperate more fully with the SEC. Indeed, in entering into the DPA with Tenaris, the SEC cited the company's "immediate self reporting, thorough internal investigation, full cooperation with SEC staff, enhanced anti-corruption procedures, and enhanced training" and gave credit for displaying "an exemplary commitment to compliance, cooperation, and remediation."[22]

However, both the DOJ and SEC have long insisted that corporate defendants who voluntarily disclose FCPA issues and cooperate with the government will receive leniency. Most companies, therefore, have already been conditioned to accept the DOJ's and SEC's longstanding position that companies are rewarded for self-disclosure, cooperation, and remedial actions with respect to FCPA dispositions. Furthermore, the DOJ has long used different levels of sanctions—NPAs, DPAs, and criminal charges—to reward or punish companies based on the seriousness of the underlying conduct, whether the company self-disclosed, the company's cooperation and compliance program, and the remedial actions taken. Thus, from a corporate defendant's

perspective, it may not be immediately clear whether the possibility of entering into a DPA or NPA with the SEC in an FCPA matter provides an additional incentive for cooperation.

However, the SEC will undoubtedly find that the use of NPAs and DPAs gives the agency much more flexibility. First, the SEC will have additional flexibility to align its dispositions with those of the DOJ. Second, like an administrative order, the NPA and DPA do not require an admission of guilt, permitting the SEC to set a lower bar with respect to the amount of evidence necessary to bring an FCPA enforcement action. Finally, the agreements provide the SEC with additional leverage over companies to ensure that those companies adhere to remedial measures outlined in the agreements. Thus, the agreements are likely to further empower the SEC, both with the ability to bring additional enforcement actions and with the ability to maintain leverage over companies during the terms of the agreement. Accordingly, by strengthening the SEC's enforcement capabilities, the agreements may ultimately serve their intended purpose of facilitating even more self-disclosures and cooperation by corporate defendants in FCPA enforcement actions.

Morgan A. Heavener is a senior associate and Elizabeth L. Norton is an associate in the Litigation Department at the global law firm, Paul Hastings. Both are members of the firm's Global Compliance and Disputes practice group and are resident in the firm's Washington, DC office.

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1 Securities and Exchange Commission, Press Release, ***Tenaris to Pay $5.4 Million in SEC's First-Ever Deferred Prosecution Agreement*** (May 17, 2011) [hereinafter "Tenaris SEC Press Release"].

2 **Deferred Prosecution Agreement between Tenaris, S.A. and U.S. Securities & Exchange Commission** (May 17, 2011), [hereinafter "Tenaris DPA"].

3 Department of Justice, Press Release, ***Tenaris Agrees to Pay $3.5 Million Criminal Penalty to Resolve Violations of the Foreign Corrupt Practices Act*** (May 17, 2011) [hereinafter "Tenaris DOJ Press Release"].

4 Securities and Exchange Commission, Press Release, ***SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations*** (Jan. 13, 2010).

5 Id.

6 Id.

7 Id.

8 Enforcement Manual, SEC Division of Enforcement, Office of Chief Counsel (Feb. 8, 2011), Section 6.2. On June 13, 2011, the SEC revised its rules to provide the SEC Director of Enforcement the authority to issue immunity requests to compel individuals to give testimony or provide other information. The January 2010 Enforcement Manual provided for the Director of Enforcement to submit such requests to the DOJ.

9 Id. at 6.1.2.

10 Id. at 6.2.3 & 6.2.4.

11 Enforcement Manual, SEC Division of Enforcement, Office of Chief Counsel (Feb. 8, 2011), Section 6.2.3.

12 Id. at 6.2.3.

13 **Non Prosecution Agreement between Carter's Inc. and U.S. Securities & Exchange Commission** (Dec. 17, 2010).

14 The open-ended nature of the Carter's NPA is in contrast to the two-year Tenaris DPA. Other significant differences between the Carter's NPA and the Tenaris DPA are that the Carter's agreement does not include a statement of facts and does not include any financial penalty. Although nothing in the enforcement manual requires such distinctions between the two types of

agreement, the manual provides sufficient flexibility to permit them.

15 As used by the DOJ, DPAs are submitted, along with a formal charging document, and, typically, a statement of facts, to an appropriate court. An NPA in the DOJ context is not filed with a court and there is no admission of wrongdoing.

16 See, e.g., In the Matter of Ball Corporation, SEC Administrative Proceeding **File No. 3-14305** (2011); In the Matter of Rockwell Automation, Inc., SEC Administrative Proceeding **File No. 3-14364** (2011).

17 See Tenaris DPA, at ¶ 6.

18 See Tenaris SEC Press Release.

19 See Tenaris DOJ Press Release.

20 Interestingly, the SEC press release for the Tenaris investigation notes that the investigation was led by the SEC's Salt Lake Regional Office in addition to the Enforcement Division's FCPA Unit.

21 Tenaris DPA, at ¶ 8. The DPA further notes that Tenaris had already undertaken significant remedial measures, including reviewing, updating, and improving its existing compliance program by strengthening the company's Code of Conduct, Business Conduct Policy, and enhanced due diligence procedures for the retention of and payments to third party agents. See Tenaris DPA, at ¶ 6.bb.

22 Tenaris SEC Press Release.