

Morgan Stanley Goes One for One with a Best Practices Compliance Program

On Monday night, Houston Astros manager Brad Mills went to the mound five times to change pitchers against five straight New York Mets batters. This set the Astros twitter community literally 'a-twitter' as it was noted that, according to the Elias Sports Bureau, the "Astros became the 1st team in MLB history to use 5 different pitchers against 5 consecutive hitters." Why did he do so? Mills has not made public his reasons yet it seemed to work out as only one of the five hitters was able to get a hit against the normally abysmal Astro relief corp. And the Astros actually won the game, which is an increasing rare occurrence this season since having a winning record of 2-1 after three games.

I thought about the Mills treks to the mound last night when reading the recent Foreign Corrupt Practices Act (FCPA) enforcement action against former Morgan Stanley Managing Director Garth Peterson. According to the US Department of Justice (DOJ) Press Release, Peterson pled guilty to one count of criminal information charging him with "conspiring to evade internal accounting controls that Morgan Stanley was required to maintain under the FCPA." Assistant Attorney General Lanny Breuer was quoted as saying, "Mr. Peterson admitted today that he actively sought to evade Morgan Stanley's internal controls in an effort to enrich himself and a Chinese government official. As a Managing Director for Morgan Stanley, he had an obligation to adhere to the company's internal controls; instead, he lied and cheated his way to personal profit. Because of his corrupt conduct, he now faces the prospect of prison time." Peterson will be sentenced in June.

The Allegations

According to the DOJ Press Release, Peterson conspired with others to circumvent Morgan Stanley's internal controls in order to transfer a multi-million dollar ownership interest in a Shanghai building to himself and a Chinese public official with whom he had a personal friendship. Peterson encouraged Morgan Stanley to sell an interest in a Chinese real-estate deal to Shanghai Yongye Enterprise (Yongye) a state-owned and state-controlled entity through which Shanghai's Luwan District managed its own property and facilitated outside investment. Peterson falsely represented to others within Morgan Stanley that Yongye was purchasing the real-estate interest, when in fact Peterson knew the interest would be conveyed to a shell company controlled by him, a Chinese public official associated with Yongye and an un-named Canadian attorney. After Peterson and his co-conspirators falsely represented to Morgan Stanley that Yongye owned the shell company, Morgan Stanley sold the real-estate interest in 2006 to the shell company at a discount to the interest's actual 2006 market value. As a result, the conspirators realized an immediate paper profit of more than \$2.5 million. Even after the sale, Peterson and his co-conspirators continued to claim falsely that Yongye owned the shell company. In the years since Peterson and his co-conspirators gained control of the real-estate interest, they have periodically accepted equity distributions and the real-estate interest has appreciated in value.

Declination to Prosecute

However, the greater import of this enforcement action for my money was what did NOT happen to Morgan Stanley. They were not indicted. In fact both the DOJ, in its Press Release, and Securities and Exchange Commission (SEC), in its civil Complaint, went out of their way to praise the Morgan Stanley compliance program. This written praise demonstrated that not only do company's receive credit from the DOJ for having a compliance program in place but also gave solid information as to why the DOJ declined to prosecute Morgan Stanley. In other words, it was a very public pronouncement of a declination to prosecute.

The SEC Complaint detailed the compliance program it had in place and how it directly related to Peterson. The Complaint specified:

- (1) Morgan Stanley trained Peterson on anti-corruption policies and the FCPA at least seven times between 2002 and 2008. In addition to other live and web based training, Peterson participated in a teleconference training conducted by Morgan Stanley's Global Head of Litigation and Global Head of Morgan Stanley's Anti-Corruption Group in June 2006.
- (2) Morgan Stanley distributed to Peterson written training materials specifically addressing the FCPA, which Peterson maintained in his office.
- (3) A Morgan Stanley compliance officer specifically informed Peterson in 2004 that employees of Yongye, a Chinese state-owned entity, were government officials for purposes of the FCPA.
- (4) Peterson received from Morgan Stanley at least thirty five FCPA-compliance reminders. These reminders included FCPA-specific distributions; circulations and reminders of Morgan Stanley's Code of Conduct, which included policies that directly addressed the FCPA; various reminders concerning Morgan Stanley's policies on gift-giving and entertainment; the circulation of Morgan Stanley's Global Anti-Bribery Policy; guidance on the engagement of consultants; and policies addressing specific high-risk events, including the Beijing Olympics.
- (5) Morgan Stanley required Peterson on multiple occasions to certify his compliance with the FCPA. These written certifications were maintained in Peterson's permanent employment record.
- (6) Morgan Stanley required each of its employees, including Peterson, annually to certify adherence to Morgan Stanley's Code of Conduct, which included a portion specifically addressing corruption risks and activities that would violate the FCPA.
- (7) Morgan Stanley required its employees, including Peterson, annually to disclose their outside business interests.

(8) Morgan Stanley had policies to conduct due diligence on its foreign business partners, conducted due diligence on the Chinese Official and Yongye before initially conducting business with them, and generally imposed an approval process for payments made in the course of its real estate investments. Both were meant to ensure, among other things, that transactions were conducted in accordance with management's authorization and to prevent improper payments, including the transfer of things of value to officials of foreign governments.

Based on the foregoing, the DOJ declined to prosecute Morgan Stanley and noted in its Press Release, "After considering all the available facts and circumstances, including that Morgan Stanley constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the Department of Justice declined to bring any enforcement action against Morgan Stanley related to Peterson's conduct. The company voluntarily disclosed this matter and has cooperated throughout the department's investigation."

Compliance Program as Compliance Defense

The second point of note in this enforcement action is that if it was not clear that a company receives credit for having a *best practices* compliance program it is now. Recognizing that a compliance program is not available as a formal affirmative defense, it is clear that Morgan Stanley was able to use not only their written compliance program, but its ongoing maintenance, communication and due diligence aspects to shield the employer from liability. Remember that Peterson was a Managing Director for Morgan Stanley. This is not a low level functionary but a person far up the food chain. Neither the DOJ nor the SEC invoked the doctrine of *Respondeat Superior* in any enforcement action against Morgan Stanley. The bottom line is what the DOJ and SEC representatives have been saying all along and that is that companies with best practices compliance programs receive credit in negotiating with the government. Here the DOJ spelled it out in their Press Release so kudos to the DOJ and SEC for doing so in such a public manner.

What Can You Do?

So what can you as a compliance officer do with the lessons learned from this enforcement action? Borrowing from my *This Week in FCPA* Colleague Howard Sklar's recent blog post, entitled "*The Most Marketable Compliance Officer In The World*" I suggest the following:

(1) Regularly update your policies and procedures. The DOJ has said over and over, and has included in Schedule C - its description of an effective anti-corruption compliance program - that companies must update programs, and have several areas of compliance mentioned. Morgan Stanley took that lesson and did exactly what the DOJ expected.

(2) Increase the frequency of your training. Peterson was trained on the FCPA seven times and over a 7-year period Morgan Stanley trained its Asia-based employees 54 times on anti-corruption. This clearly shows that training is important and the documentation of training is critical. How else was Morgan Stanley able to demonstrate the DOJ just how many training sessions Peterson had sat through?

(3) Send out compliance reminders. Peterson received reminders about FCPA compliance 35 times. This is an easy and quick action that you can take often. You can send them out by email, use your internal messaging system or a myriad of other media. Better yet, you could write an email for your company President pointing out that Morgan Stanley was NOT indicted because it had such a robust compliance program.

(4) Engage in ongoing Due Diligence, including transaction monitoring. As Howard noted, “Morgan Stanley had a robust due diligence program. The program included transaction monitoring - a sure sign that a company really cares about diligence is the extent it realizes diligence is ongoing - and included random audits of people and partners.” Ongoing due diligence and monitoring is becoming the new normal so I suggest that you get ahead of the curve, as in now.

I believe that the Peterson enforcement action is one of the most significant in 2012 to date. It provides solid guidance to the compliance practitioner on what the DOJ and SEC think is important and gives you actions that you can engage in now to increase the visibility of your compliance program within your company. Kudos to Morgan Stanley for their compliance victory. You do not have to parade in five pitchers to pitch to five different batters as Brad Mills did, but I think the import should be to take action now.

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