

**Contacts:**

**Christopher R. Hall**  
Chair

**Nicholas J. Nastasi**  
Vice Chair

**Courtney L. Schultz**  
Newsletter Editor

**Amy L. Piccola**  
Contributor

**Patrick M. Hromisin**  
Contributor

**White Collar  
and Government  
Enforcement  
Practice**

# White Collar Watch

The Newsletter of the White Collar and Government Enforcement Practice

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## **Government Contractor Indictments Provide Reminder of Importance of Strong Workplace Policies, Training and Enforcement**

By Nicholas J. Nastasi, Jr. and Amy L. Piccola

A series of indictments, the most recent in August, remind government contractors of the increased scrutiny on the industry and the very real risk of employee fraud and abuse. Government contractors are encouraged to heed the warning and to make sure they have effective compliance programs in place and that those programs are strictly enforced.

### **The Indictments**

On August 23, 2012, the United States District Court for the Southern District of California unsealed an indictment charging Robert Ehnou, the owner and President of L&N Industrial Tool & Supply, Inc. ("L&N"); Joanne Loehr, the owner and operator of Centerline Industrial Inc. ("Centerline"); and Centerline itself with conspiring with Navy officials to commit bribery, wire fraud, and money laundering at the Naval Air Station North Island ("NAS North Island"), in Coronado, California. L&N and Centerline are both defense contractors.

According to the indictment, L&N and Centerline provided certain civil Navy officials with over \$1 million in personal benefits, including cash, checks, retail gift cards, flat screen television sets, luxury massage chairs, home furniture and appliances, bicycles, model airplanes, and home remodeling services. In return, the Navy officials placed millions of dollars in government orders with the defense contractors. The indictment alleges that Ehnou and Loehr conspired with their sales managers, with Navy officials, and with others, to engage in this conspiracy. Both contractors allegedly prepared and submitted fraudulent invoices to the Department of Defense, making it appear that they were billing the Department for goods and services within the scope of legitimate government contracts. In reality, the Defense Department was allegedly unknowingly paying for, among other things, the cost of the bribes to the Navy officials. During the course of the alleged conspiracy, the Department paid L&N over \$3 million, while Centerline received over \$1 million.

In March 2012, seven individuals admitted their involvement in the fraudulent scheme, pleading guilty to all charges in an indictment. Of the seven defendants, four were Navy officials who admitted to receiving a collective total of more than \$1 million in cash, goods and services, all fraudulently charged to and paid for by the Department of Defense. The remaining three defendants who pled guilty were owners or employees of various defense contractors, including L&N and Centerline, that provided goods or services for NAS North Island.

According to the United States Attorney for the Southern District of California, the investigation and eventual indictments were initiated on the basis of citizen complaints. Following a July 2009 indictment of six individuals on fraud and corruption charges centered at the Space and Naval Warfare Systems Command (SPAWAR), the government announced a hotline dedicated to the reporting of possible waste, fraud and abuse related to government and military contracts. Calls to the hotline provided information related to the alleged NAS North Island fraudulent scheme, directly resulting in the two indictments.

Representatives of the FBI, Defense Criminal Investigative Service, IRS-Criminal Investigation and NCIS have all commented that putting an end to fraud by government officials and defense contractors is a "number one criminal priority" and that law enforcement will continue to encourage, and rely upon, information provided by the public.

### What Government Contractors Can, And Should, Do

Given the rising cost of fraud to the government, it is not surprising that government contractors are more heavily scrutinized now than ever before. The risk to government contractors of employee fraud is significant: criminal liability and suspension or disbarment from government contracting are all possibilities. The combined reality of increasing fraud and heightened scrutiny make it critical that even the smallest of companies create, implement and enforce an effective ethics and compliance program.

The first step in developing an ethics and compliance program is to understand the rules and regulations that govern the company's business and to determine the areas within the company facing the highest compliance risks. After identifying high-risk areas, a company should implement a training program targeted at employees whose job responsibilities intersect with those risks. Training should be repeated and reiterated to remind employees of the rules governing their, and the company's, conduct. Finally, because misconduct can rarely be completely eliminated, companies must establish effective means to monitor compliance, including, for example, establishing a system for reporting suspected abuse and assigning a high-level employee to oversee and examine compliance issues. If misconduct does occur, immediate disciplinary action should be taken and corrective measures implemented to prevent recurrence.

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## Winter Olympics in Russia Set Stage for FCPA Scrutiny

By Nicholas J. Nastasi, Jr. and Patrick M. Hromisin

With the conclusion of the 2012 Summer Olympics in London, the world's eyes will soon turn to Sochi, the Black Sea resort city in Russia, which will host the 2014 Winter Olympics. In addition to serving as the backdrop for the usual feats of athletic prowess and national pride, the Sochi games may also be fertile ground for prosecutions under the United States' Foreign Corrupt Practices Act (FCPA). The U.S. government's

actions in this setting will serve as a signal to any company doing business abroad that it must be proactive in ensuring compliance with the FCPA.

The FCPA is a federal statute that criminalizes the action of giving or offering anything of value to improperly influence foreign officials in order to further a business interest. Passed in

1976, while the United States was still processing the fallout from the Watergate scandal, it was the first statute on record in any nation to criminalize bribing foreign officials. FCPA prosecutions have increased in the past decade. In 2004, the Department of Justice charged two individuals with FCPA violations and collected roughly \$11 million in fines. In 2009 and 2010 combined, 50 individuals were charged with FCPA violations, and the government collected just under \$2 billion in fines. Assistant Attorney General Lanny Breuer of the Criminal Division also noted last November that in 2011 the Department went to trial on more FCPA cases than ever before, and also secured the longest prison sentence – 15 years – ever imposed under the FCPA.

In addition, the Department of Justice has signaled its intention to focus its attention on corruption in Russia. In March of 2011, Assistant Attorney General Breuer spoke at an anti-corruption summit in Moscow and touted the FCPA's effect on U.S. companies doing business in Russia. He stated, "the FCPA is a strong enforcement mechanism, and we are not shy about using it. Indeed, the threat of liability under the FCPA is itself a powerful tool, particularly for those from whom Russian officials seek bribes. . . . To the extent that an individual doing business in Russia understands that he or she may be prosecuted under the FCPA for bribing a Russian official, the Act provides a strong incentive for him or her to play by the rules, and a good reason for refusing not to."

Two factors, in particular, indicate that the Sochi Olympics will be on federal prosecutors' radar screens between now and 2014. First, the infrastructure required to make Sochi ready to host the Games is massive and costly. Although any Olympic host city must spend a great deal on venues, transportation, and the like, Sochi must undertake more construction than other recent hosts. Prior to its Olympic bid, the city was better-known as a summer resort; for example, until 2009, its proposed ski slopes were covered in forest. The estimated cost of construction has exploded to over \$35 billion, far beyond the \$11 billion that was initially budgeted. U.S.-based multinational companies have won, or are angling to win, contracts for these projects. For example, GE has already provided turbines that will provide electrical power at the Sochi Olympic

sites, and a spokesperson for Dow Chemical has announced that Dow has won contracts for work at every single competition venue being constructed there.

The second factor that will lead to scrutiny of companies doing business associated with the Sochi Olympics is Russia's pervasive atmosphere of corruption. Russia has consistently ranked low on well-respected international surveys of corruption, such as the Transparency International Corruption Perceptions Index, on which it ranked 143rd out of 182 countries in 2011. There have also been allegations of corruption specifically related to the infrastructure projects being undertaken for the 2014 Games. Expatriate Russian businessman Valery Morozov has accused Vladimir Leshchevsky, a government official, of taking bribes to award Sochi construction projects, even detailing a bribe he says he paid to Leshchevsky. One article a Russian news wire published about the preparations for the games was entitled, "Corruption Making Sochi Olympics Most Expensive in History."

Russia itself recognizes its corruption problem, and in May of 2011, passed legislation similar to the FCPA, criminalizing the actions of offering and accepting bribes. This legislation applies to foreign entities doing business in Russia, so an individual who runs afoul of the FCPA due to bribery in Russia may also be in violation of Russian law. Earlier this year, Russia also joined the Organization for Economic Cooperation and Development (OECD) anti-bribery convention, which was a condition for Russia to join the OECD itself. Even if the Russian legislation proves effective in decreasing corruption, though, Russian attitudes and practices will surely be slow to change.

Companies seeking to do business in Russia during the run-up to the Sochi Olympics would be well-served to review their FCPA compliance regimes, and strengthen them if necessary. A recent case involving financial services firm Morgan Stanley provides a powerful example of how useful a good compliance program can be. From 2004 to 2007, Morgan Stanley managing director Garth Peterson allegedly provided improper payments to a Chinese official in Shanghai. In April of this year, the Department of Justice and Securities and Exchange

Commission charged him criminally and civilly for that conduct, but neither agency charged Morgan Stanley with any wrongdoing. The likely reason that Morgan Stanley avoided liability was that it had a robust anti-bribery compliance program, with numerous "reminders" about company policy and applicable laws on the issue. The company also conducted a thorough investigation when Peterson's conduct was brought to its attention, and fired Peterson in 2008.

Although a limited number of companies will be taking part in the preparations for the Olympics, any company doing business abroad must take steps to ensure its compliance with the FCPA. Creating and actively enforcing an anti-bribery compliance program along the lines of Morgan Stanley's can help companies avoid FCPA liability whether they are helping set the stage for the next Olympics or conducting business in any corner of the globe.

## The Saul Ewing White Collar and Government Enforcement Practice

**Christopher R. Hall, Chair**  
215.972.7180  
chall@saul.com

**Nicholas J. Nastasi,  
Vice Chair**  
215.972.8445  
nnastasi@saul.com

**Jennifer L. Beidel**  
215.972.7850  
jbeidel@saul.com

**Andrea P. Brockway**  
215.972.7114  
abrockway@saul.com

**Brett S. Covington**  
202.295.6689  
bcovington@saul.com

**Jennifer A. DeRose**  
410.332.8930  
jderose@saul.com

**Justin B. Ettelson**  
215.972.7106  
jettelson@saul.com

**Patrick M. Hromisin**  
215.972.8396  
phromisin@saul.com

**Sarah F. Lacey**  
410.332.8791  
slacey@saul.com

**Allison B. Newhart**  
215.972.7191  
anewhart@saul.com

**Joseph F. O'Dea, Jr.**  
215.972.7109  
jodea@saul.com

**Amy L. Piccola**  
215.972.8405  
apiccola@saul.com

**Christine M. Pickel**  
215.972.7785  
cpickel@saul.com

**Courtney L. Schultz**  
215.972.7717  
cschultz@saul.com

**Gregory G. Schwab**  
215.972.7534  
gschwab@saul.com

**Nicholas C. Stewart**  
202.295.6629  
nstewart@saul.com

**Chad T. Williams**  
302.421.6899  
cwilliams@saul.com

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