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Securities Litigation, Enforcement, and White-Collar Criminal Defense Newsletter, Summer 2008

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In This Issue

This edition of the Securities Litigation, Enforcement, and White-Collar Criminal Defense Newsletter opens with an overview of recent trends in enforcement of the Foreign Corrupt Practices Act, an area in which we expect to see more government action. We then turn to a primer on recently announced guidelines for the appointment of independent corporate monitors, which are often a feature of non-prosecution or deferred prosecution agreements with corporations. Next, our colleague and legendary trial lawyer, Jim Brosnahan, reviews ten things you can do to steer clear of potential criminal problems. We follow with an update on a recent Ninth Circuit case involving SEC and Department of Justice cooperation—and the unusual events surrounding a request for an *en banc* hearing. We close with a report on the progress of an advisory committee to the SEC that is looking for ways to reduce the number of restatements.

Our goal for our newsletter is to provide our friends with timely, brief, and relevant reports on interesting issues. We hope you enjoy this edition, which touches on some of the many issues our attorneys in the U.S., Europe, and Asia litigate and follow. Thanks for reading.

The Foreign Corrupt Practices Act: Trends & Risk Factors
By Randall J. Fons and Brian Neil Hoffman

Enforcement of the Foreign Corrupt Practices Act ("FCPA") is an important priority for the SEC and the DOJ, and last year represented a banner year for the government. The number of cases filed in 2007, including cases against individuals, grew significantly from prior years as the government dedicated more resources to FCPA enforcement. Additionally, the cost of settling FCPA violations has dramatically risen. Settlements in 2007 included the largest criminal penalty in FCPA history ($26 million) and the largest overall financial payment ($44 million). Moreover, the government continues to regularly seek disgorgement of profits earned from the business allegedly won as a result of a bribe, as well as costly and burdensome non-monetary penalties.

Companies must take a global view of their FCPA compliance cultures. Violations by a subsidiary, even if foreign-based, could subject the parent company to liability. Further complicating matters, companies may be liable for actions of third-party "consultants" hired in the local country. The definition of a "prohibited payment" is also complicated and subject to 20/20 hindsight review by the government.

Certain industries and countries may require additional compliance efforts. Companies with frequent contact with foreign officials, such as companies involved in foreign infrastructure projects, seem to account for a high percentage of recent FCPA cases. In addition, companies doing business in countries such as China with

numerous wholly or partially state-owned enterprises face complex questions of whether the individual with whom they are interacting is a foreign official under the FCPA. Certain countries' perceived corrupt business norms pose greater risks.

Once a potential violation has been discovered, a company's entire international operations may be subject to review. Companies who discover a problem are well advised to ask themselves where in the company other FCPA issues might exist, because the government is likely to do so. Additionally, violations discovered at one company may lead to an expanded government inquiry into other companies in related industries. Companies may also simultaneously be subject to various domestic and foreign regulatory investigations, and the U.S. government may condition resolution of domestic FCPA violations on a company's resolution with foreign regulators as well.

In short, more frequent, and costly, enforcement of the FCPA is likely here to stay. Companies doing business abroad thus should, among other things, adopt and enforce FCPA controls (both domestically and internationally), conduct frequent training, and engage experienced FCPA counsel at the first signs of potential trouble.

Randall J. Fons is a partner and Brian Neil Hoffman is an associate in the firm's Denver office.

New Guidelines for Independent Corporate Monitors
By Robert Salerno

With increasing frequency, federal prosecutors are using deferred prosecution agreements ("DPAs") and non-prosecution agreements ("NPAs") to resolve criminal investigations against corporations. Many DPAs and NPAs require the appointment of an independent corporate monitor to oversee and report on the corporations' compliance with the terms of those agreements. In response to the controversy surrounding the selection by the U.S. Attorney for New Jersey of former Attorney General John Ashcroft as a corporate monitor (from which Ashcroft's firm stands to gain as much as $52 million in fees), the Department of Justice ("DOJ") recently issued guidance to federal prosecutors regarding the selection and use of monitors. The guidelines address conflicts of interest, communications between the monitor and the government, and other issues important to corporations that may be required to implement DPAs and NPAs that provide for the appointment of a corporate monitor.

According to the guidelines, which were issued on March 7, 2008 by acting Deputy Attorney General Craig Morford, an individual prosecutor may no longer unilaterally select the corporate monitor. Monitor candidates must now be considered by an ad hoc committee within the U.S. Attorney's Office or the DOJ component handling the criminal case, and the selection of a monitor must now be approved by the Deputy Attorney General. Also, the monitor must not have any relationship with a corporation that would cause a reasonable person to question the monitor's independence, and the corporation must agree that it will not employ the monitor for at least one year after the monitorship is terminated.

In the event the monitor finds previously undisclosed or new misconduct, the DPA or NPA should specify what kinds of matters the monitor must report, leaving the reporting of other kinds of matters to the discretion of the monitor. It should also address the duration and scope of the monitorship, and should permit extensions or reductions of the monitor's term, as circumstances warrant. Significantly, the agreement should make it clear that the corporation's failure to adopt a recommendation made by the monitor within a reasonable period of time will be reported to the government and considered in evaluating whether the corporation has fulfilled its obligations under the agreement. A corporation's failure to fulfill such obligations could result in the filing of formal criminal charges (where there was an NPA in place) or the resumption of the deferred prosecution (where there was a DPA in place).

The guidelines do not address when prosecutors should use a DPA or NPA to resolve a criminal case. Nor do they address when, in the context of a negotiated DPA or NPA, the appointment of a monitor is appropriate. They do, however, provide companies with a better idea of what to expect when negotiating agreements that include the appointment of a corporate monitor.

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So You Think Your Company Will Never Be Indicted?
By James J. Brosnahan

Here are 10 things that could prevent a criminal problem. They are taken from real law practice over the years and made generic. It is not possible to identify any client from these descriptions, but one way or another they have happened to corporate officers and companies who were ill-prepared for the experience of a criminal case. If there is value here, it is because preventative law is the best law.

These reminders can help a client avoid criminal exposure.

Be on the lookout for:

1. Advice from a lawyer that something is illegal but the law is in flux and a lot of companies are doing it. The last part does not sound to me like legal advice. Put in perspective, it creates a dangerous atmosphere for decision-making.
2. Financial arrangements that no one except the creator can understand. If a prosecutor does not understand the arrangement, he or she will suspect it. During the five years I served as a federal prosecutor, I had no business experience of any kind. This is not uncommon, and the prosecutorial hostility to business arrangements can come as a surprise to the client.
3. Business dealings, particularly sale arrangements, that seem normal but are forbidden by counter-intuitive, even obscure, regulations and laws. The most dangerous reaction to these regulations and laws is the conclusion, "That is not aimed at us."
4. Email chatter, especially to and from the legal department. Privileges are melting away in case after case, making email a very inappropriate and even dangerous medium.
5. Failure to appreciate what a target the company and the people in it are. High salaries can be gasoline on a prosecutor's decision-making fire.
6. Not recognizing or being aware of new Department of Justice enforcement initiatives. Suddenly and with little warning, the Department begins a new enforcement initiative. Prosecutors are assigned. Cases will be made. The prosecutors want to show results. If you hear yourself saying, "They would not prosecute people like us," give it a careful, additional look.
7. Allowing the wrong person to irritate a key regulatory agency that also has criminal statutes to enforce. People in agencies are human and when irritated can become a direct threat.
8. Advice to the board of directors from a civil lawyer with gravitas who is addressing an unusual problem with criminal implications. Civil lawyers can rarely forecast how prosecutors think or what the real risks are.
9. Situations in which the corporate income from the practice is great and it is difficult to tell a high official in the company, "We can't do that."
10. The old unreliable, "We have done this forever."

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You (Might Not) Have the Right to Remain Silent
By Mia Mazza and Amy Roebuck

Responding to a civil inquiry from the U.S. Securities and Exchange Commission ("SEC") requires careful judgment, particularly when one knows or suspects the United States Department of Justice ("DOJ") is conducting a criminal investigation. It has long been the case that when the SEC asks for information, there can be serious consequences from *not* providing it. Failing to supply information requested in an SEC subpoena may result in criminal sanctions, possibly even imprisonment for a year or more. And there is now pressure even to hand over attorney-client privileged materials (thus waiving the privilege for other purposes), as the SEC considers a waiver of privilege in assessing whether a company or individual has cooperated in the investigation. (See discussion in our Winter 2008 Newsletter.)

A recent Ninth Circuit case, however, confirms that the consequences of providing requested information to the SEC in a civil inquiry could be more serious than expected: the request may actually be coming from the DOJ as part of an undisclosed criminal investigation.

In *U.S. v. Stringer, et al.*, 521 F.3d 1189 (9th Cir. April 4, 2008), the Ninth Circuit Court of Appeals ruled that the DOJ may, without initiating an official criminal investigation, work behind the scenes to shape SEC requests and discovery strategies to garner information that the subject of the SEC request might not voluntarily supply if he or she knew a criminal investigation was underway. The Ninth Circuit held that SEC

Form 1662 sufficiently advises the target that by providing the SEC with information, the target is waiving his or her Fifth Amendment right against self-incrimination. Form 1662, a five-page boilerplate form given to companies and individuals in connection with any request for information, states in relevant part that the SEC routinely "makes its files available" to other governmental agencies, that information provided to the SEC "may be used against you" in a criminal proceeding brought by another agency, and that "you may refuse . . . to give any information that may tend to incriminate you."

According to the Ninth Circuit, however, the SEC is *not* required to disclose that the DOJ has already initiated a secret criminal investigation against the target or that the DOJ is effectively driving the SEC's civil discovery actions. In fact, the panel held, the SEC is permitted to "actively conceal" the DOJ's participation (*e.g.*, evading counsel's direct questions as to whether the SEC's requests were being made in conjunction with the DOJ), so long as no "affirmative falsehood" is made. Before the Ninth Circuit panel's opinion in *Stringer*, several federal courts around the country had authorized the sharing of information between the SEC and the DOJ in "parallel" investigations, where the target was aware of both proceedings. But until the panel ruling in *Stringer*, the courts had not endorsed this degree of DOJ "behind the scenes" involvement — providing significant input into SEC discovery strategies, directing the SEC to probe, or not probe, certain areas, and even changing the location of testimony to lay venue in the prosecutor's district for a potential perjury charge — where the subject did not know that a criminal investigation was in progress.

On May 7, 2008, Chief Judge Ancer L. Haggerty of the District of Oregon, who issued the district court ruling in *Stringer*, took the unusual step of invoking Ninth Circuit General Order 12.10(b) to provide the Ninth Circuit with a letter outlining the reasons why he "respectfully disagree[s] with the panel's conclusions." Judge Haggerty's letter was attached as an exhibit to Stringer's May 18, 2008 petition for rehearing *en banc*. The Ninth Circuit directed the government to respond to the petition for rehearing; a decision on the petition is pending.

Whatever the end result of this controversy, it highlights the fact that the SEC and the DOJ can collaborate, and will continue to collaborate, in unexpected — and sometimes undisclosed — ways. Counsel and clients should discuss the advantages and disadvantages of responses to civil requests to make sure there is no inadvertent waiver of the client's Fifth Amendment rights that could prejudice the client's defense in a criminal action.

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SEC Advisory Committee Considers Ways to Reduce Number of Restatements
By Adriano Hrvatin

In July 2007, the SEC established the Advisory Committee on Improvements to Financial Reporting to recommend ways to reduce the complexity of financial reporting and provide more useful information to the investing public. The Advisory Committee has developed a host of proposals over the past year — from ending industry-specific guidance to requiring companies to submit their financial statements with electronic-tagging technology. One proposal of particular interest is to limit corporate financial restatements to those involving "meaningful" reporting errors.

The number of restatements filed with the SEC increased from 116 in 1997 to 1,876 in 2006. Nearly 10% of public companies issued restatements in 2006 — which the SEC's Chief Accountant in August 2007 described as "an alarmingly high number." The Advisory Committee has stated that too many decisions to restate are made without full consideration of whether a reasonable investor would consider the error meaningful, and thus material. The result, according to the Advisory Committee, has been a significant number of "unnecessary" restatements.

The Advisory Committee has proposed three principles for determining when a restatement is necessary. *First*, those who evaluate the materiality of an accounting error should make the decision to restate based on the perspective of the reasonable investor. *Second*, decision-makers should consider how the error affects the total mix of information that is available to the reasonable investor. *Third*, decision-makers should apply a "sliding scale" of quantitative and qualitative factors: the higher the quantitative significance of an accounting error, the stronger the qualitative factors must be to conclude that the error is immaterial, and vice versa. These principles, taken together, could reduce the number of restatements, especially for small or stale corrections or corrections for highly technical accounting reasons.

The Consumer Federation of America, a consumer-advocacy group, has criticized the Advisory Committee, and warned at a two-day public meeting in March 2008 that the proposal "would weaken the materiality standard

and provide less transparency about the reporting of financial statement errors." The Advisory Committee nonetheless confirmed at the March 2008 meeting that it would continue to pursue its recommendation. The Advisory Committee is expected to make a formal recommendation to the SEC in August 2008. The fall SLEW newsletter will report on that recommendation and the SEC's response.

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