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Contacts:

Christopher R. Hall
Chair

Nicholas J. Nastasi
Vice Chair

Courtney L. Schultz
Newsletter Editor

Jennifer A. DeRose
Contributor

Justin B. Ettelson
Contributor

Amy L. Piccola
Contributor

Saul Ewing LLP

White Collar and Government Enforcement Practice

White Collar Watch

The Newsletter of the White Collar and Government Enforcement Practice

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Indictment of BP Employee Highlights Importance of Taking Control in Response to a Government Subpoena

By Nicholas J. Nastasi and Jennifer A. DeRose

On April 23, 2012, Kurt Mix, a former engineer for BP plc, was charged with two counts of intentionally destroying evidence requested by federal law enforcement authorities investigating the Deepwater Horizon oil spill disaster. The details of the criminal complaint highlight the importance of diligent handling of both internal investigations and document collections in response to government subpoenas. The issuance of one, or even several, legal hold notices may not deter every employee from destroying potentially incriminating emails or texts, and the destruction of evidence will likely lead to criminal liability for employees, and potentially for employers, too.

The Deepwater Horizon rig explosion in April 2010 killed 11 workers and spilled an estimated 4.9 million barrels of oil into the Gulf, leading the U.S. Department of Justice to launch a criminal investigation of the spill. The Mix indictment is the first criminal indictment in that investigation, which is ongoing.

According to charging documents, Mix was a BP drilling and completions project engineer who worked on the company's efforts to stop the flow of oil, including the ultimately unsuccessful "Top Kill" strategy. In the course of his work, Mix allegedly created and reviewed BP data regarding the rate at which oil was flowing from the well in the days after the explosions, a key factor for the projected viability of the Top Kill effort. The indictment alleges that BP's internal estimates of the oil flow rate, as reflected in certain text messages between Mix and others, were several times higher than the company was publicly acknowledging at the time – too high, according to BP's own engineers, for the Top Kill effort to have a reasonable chance of success.

In August 2010, government investigators contacted Mix's attorney to set up a collection of his PDA and laptop for imaging, and subsequent forensic analysis allegedly revealed that after government investigators had requested access to his devices, Mix deleted "all of the over 100 text messages" between Mix and a contractor working with BP. Then, in late September, Mix was contacted by a third-party vendor hired by BP's attorneys to collect documents. The government claims that after having been contacted by the vendor, Mix also deleted "his entire string of over 200 texts" with his supervisor. Forensic analysis allegedly revealed that the deleted texts included messages showing Mix's real-time flow-rate analysis during the Top Kill operation.

Mix allegedly received a total of six legal hold notices in the two months during and immediately after the spill, but if the forensic analysis of his devices proves to be correct, BP may face liability for failing to prevent Mix's alleged noncompliance. In certain circumstances, the law may hold BP accountable even if a litigation hold had been properly implemented, because "discovery obligations do not end with the implementation of a 'litigation hold'—to the contrary, that's only the beginning. Counsel must oversee compliance with the litigation hold, monitoring the party's efforts to retain and produce the relevant" evidence. *Zubulake v. UBS Warburg L.L.C. (Zubulake V)*, 229 F.R.D. 422, 432 (S.D.N.Y. 2004).

While the charging documents do not suggest that BP was in any way liable for Mix's activities, the indictment serves as a timely reminder that employees may benefit from training or other reminders about the importance of compliance with legal hold notices, because an employee's efforts to destroy documents in a misguided attempt to protect him or herself or the company may ultimately expose the individual, and potentially the company, to charges of obstruction of justice and witness tampering even in circumstances where no underlying criminal conduct exists.

SEC v. Citigroup: Update on SEC's Practice of Settling Cases Without Defendants Admitting or Denying Allegations

By Justin B. Ettelson

In the January 2012 edition of *White Collar Watch* [http://www.saul.com/media/site_files/3052_WhiteCollarWatch_011912_ART2sec.pdf], we reported on a November 28, 2011 decision by Judge Jed S. Rakoff of the United States District Court for the Southern District of New York, rejecting the proposed $285 million settlement of the Securities and Exchange Commission's ("SEC") lawsuit against Citigroup Global Markets, Inc. ("Citigroup"). The proposed settlement consisted of $160 million of disgorged profits, $30 million in prejudgment interest, and a $95 million civil penalty, all of which the SEC proposed would be returned to harmed investors. In rejecting the settlement, Judge Rakoff noted the "long hours trying to determine whether, in view of the substantial deference due the SEC, the Court [could] somehow approve [the] problematic Consent Judgment." Ultimately, the Court concluded that it could not "because the Court ha[d] not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment." The Court set a July 16, 2012 trial date.

The SEC sought and won a ruling from the Second Circuit Court of Appeals for a temporary stay of the Citigroup case. Motions concerning whether to continue the stay were filed on January 17, 2012 and the Second Circuit issued its decision on March 15, 2012.

Second Circuit Decision

On March 15, 2012, the Second Circuit granted a stay of the district court proceedings in the Citigroup case. Consequently, the trial scheduled to begin on July 16, 2012 was stayed and the Court ordered the submission of briefs in support of the parties' positions concerning Judge Rakoff's rejection of the settlement. In ruling to stay the proceedings, the Second Circuit concluded:

> (1) that the SEC and Citigroup...made a strong showing of likelihood of success in setting aside the district court's rejection of their settlement...; (2) the petitioning parties have shown serious…irreparable harm sufficient to justify a stay; (3)...[that a stay] will not substantially injure any other persons…; and (4) [that]...public interest…is not disserved by [granting] a stay.

The Court first addressed the district court's ruling that " a consent judgment without Citigroup's admission of liability is bad policy and fails to serve the public interest . . . ." In finding that the district court's ruling was problematic, the Court noted that the "[district] court appeared to assume that the SEC had a readily available option…that established Citigroup's liability…but chose for no good reason to settle for less." The Court also expressed concern that "the [district] court [did] not appear to…give[] deference to the SEC's judgment on wholly discretionary matters of policy." To this point, the Court held that, "[i]t is not…the proper function of federal courts to dictate policy to executive administrative agencies," and that "the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."

The Court found "no basis" to conclude that the SEC's decision was not policy-based or not made in consideration of several important factors including "the value of the particular proposed compromise, the perceived likelihood of obtaining a still better settlement, the prospects of coming out better, or worse, after a full trial, and the resources that would need to be expended in the attempt." In the case of a public executive agency, the Court held that these factors also include "how the public interest is best served," and concluded that the district court did not give "obligatory deference to the SEC's views in deciding that the settlement was not in the public interest." Finally, the Court questioned the district court's view that "the public interest is disserved by an agency settlement that does not require the defendant's admission of liability." The Court expressed concern that, "[r]equiring such an admission would in most cases undermine any chance for compromise."

Concerning the issue of irreparable harm, the Court found that "the [district] court's posture – requiring a binding admission of liability as a condition of approval of the settlement – virtually precludes the possibility of a settlement." The Court reasoned that rejection of the settlement "cannot be cured by the parties returning to the bargaining table" and that the "[district] court's intimation that it will not approve a settlement that does not involve . . . admission of liability . . . substantially reduces the possibilities of the parties reaching a settlement." This condition, consequently, constitutes "serious . . . irreparable, consequences" that can only be challenged if a stay is granted.

The Court concluded its order by finding that it sees "no appreciable harm to anyone from issuing a stay" and that it has "no reason to doubt the SEC's representation that the settlement it reached is in the public interest," or was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law."

The SEC and Citigroup's Appeal of Judge Rakoff's Decision

In its March 15, 2012 order, the Second Circuit Panel recognized that the SEC and Citigroup "are united in seeking the stay and opposing the district court's order . . . ." Consequently, it ruled that, "in order to ensure that the panel which determines the merits receives briefing on both sides, counsel will be appointed to argue in support of the district court's position." Counsel was appointed by order of the Court on March 16, 2012, and the district court's brief is due on August 13, 2012. The SEC and Citigroup, however, submitted their briefs on May 14, 2012.

The first argument presented by the SEC in its brief is that the district court erred in requiring "that a consent judgment imposing injunctive relief cannot be fair, reasonable, adequate, or in the public interest unless supported by admitted or judicially established facts . . . ." The SEC argues that, "[b]y requiring 'established' facts as a precondition to approval . . . the [district] court created a bright-line" that the "Court should reject as contrary to long-standing precedent." In support of this argument, the SEC points to the long-standing practice of government agencies generally, and in the case of the SEC specifically, to use consent judgments to "'embody a compromise' that reflects, among other things, litigation risk and the costs of trial," and "have the attributes of judicial decrees because…they always result in a judgment entered by a court." The SEC further argues that "[c]onsent decrees are crucial for agencies and courts" because of the large number of cases that can be brought and the conservation of judicial resources, "which is the primary reason for the 'strong federal policy favoring the approval and enforcement of consent decrees.'" Finally, the SEC argues that "consent judgments in which 'none of the issues are actually litigated' – because the defendants do not admit, or outright deny, the factual allegations or liability – are the norm." In support of this contention, the SEC points to several examples including securities cases brought by the SEC, antitrust cases brought by the

Department of Justice, consumer protection cases brought by the Federal Trade Commission, and environmental, public health and civil rights cases brought by a myriad of federal agencies – all of which result in consent judgments.

The second argument presented by the SEC is that the "district court did not properly defer to the [SEC's] decision to enter into a consent judgment . . . ." The SEC argues that to let this decision stand would "[interfere] with the [SEC's] ability to manage its enforcement program and allocate its resources" to the detriment of investors. The SEC further argues that the Supreme Court "has declined 'to assess the wisdom of the Government's judgment in negotiating and accepting' consent decrees, 'at least in the absence of any claim of bad faith or malfeasance on the part of the Government,'" and that where a government actor and defendant "have together 'hammered out an agreement at arm's length,'" "the '[r]espect for the agency's role' is at its apex." Failing to afford deference to a government agency that has negotiated a consent decree is not, in the words of the SEC, "in keeping with the constitutionally mandated separation of powers that assigns to the [SEC] the responsibility to execute the securities laws."

Third, the SEC argues that the district court abused its discretion by rejecting a consent judgment that is "fair, reasonable, adequate, and in the public interest" because the SEC "obtained the injunctive relief it sought in the complaint and monetary relief totaling $285 million, which is more than 80% of what it could have reasonably expected to obtain if it prevailed at trial." In furtherance of this argument, the SEC points to the fact that the judgment permanently restrained and enjoined Citigroup from further violations of the Securities Act and ordered it to pay $160 million in profits, $30 million in prejudgment interest on that disgorgement, and a $95 million penalty. Moreover, it obtained this amount "without any litigation risk." The SEC also takes issue with the district court's position that the consent judgment is not permitted because it does not provide "'collateral estoppel assistance' to private litigants or because it does not produce adjudicated facts." The SEC cites to Congress's intent to "prohibit[] the consolidation of [SEC] enforcement actions and private actions [under the Exchange Act] without the [SEC's] consent" because private suits seek to obtain damages from private actors whereas SEC suits fulfill Congress's "mandated scheme of law enforcement in the securities areas."

Finally, the SEC argues if the Court concludes it does not have jurisdiction in the case to direct appeal of the district court's order, then it should issue a writ of mandamus "because…the [SEC] will 'have no other adequate means to attain the relief it desires' . . . ." Absent a writ, the SEC will have to prepare for a trial and "lose the benefit of the bargain it struck."

Citigroup made many of the same arguments in its brief. First, Citigroup argues that "the district court's new rule, requiring settling parties to provide 'proven or acknowledged facts,' is inconsistent with the standard uniformly applied by hundreds of federal district courts." Second, Citigroup argues that "[w]here, as here, a consent judgment is voluntarily negotiated between a federal regulator and a sophisticated, well-represented party, a court should give effect to the terms negotiated." Third, Citigroup argues that the "district court abused its limited discretion in determining that the proposed [c]onsent [j]udgment is 'neither reasonable, nor fair, nor adequate nor in the public interest' expressly because it was not based on 'proven or acknowledged facts.'" Finally, Citigroup argues that "forcing defendants to admit liability as a condition of settlement…would in most cases undermine any chance for compromise."

"Examining the Settlement Practices of U.S. Financial Regulators"

As we reported in January, Khuzami announced on January 6, 2012 that the SEC will no longer settle civil cases without companies admitting or denying the charges *when the company admits wrongdoing in a parallel criminal case* (emphasis added). Said Khuzami, "[i]t . . . seemed unnecessary for there to be a 'neither admit' provision in those cases where a defendant had been criminally convicted of conduct that formed the basis of a parallel civil enforcement proceeding."

On May 17, 2012, Khuzami testified before the House Committee on Financial Services and echoed many of the arguments presented in the SEC's brief. Specifically, Khuzami noted that:

> the SEC's settlement policies…help protect investors. These policies, including the practice of permitting defendants in appropriate circumstances to settle matters on a 'neither-admit-nor-deny' basis, are common not just across federal financial agen-

> cies, but across federal agencies more generally, and they serve the critical enforcement goals of accountability, deterrence, investor protection, and compensation to harmed investors. It is for these reasons that federal courts across the country have repeatedly approved settlements including 'neither-admit-nor-deny' provisions.

Khuzami further testified that the SEC considers many factors in determining whether to settle a case with a defendant including the strength of the evidence, the delay in returning funds to harmed investors and the resources needed for trial, "including, most importantly, the opportunity costs of litigating rather devoting those resources to investigating other cases." Mr. Khuzami concluded that:

> There is little dispute that if 'neither-admit-nor-deny' settlements were eliminated, and cases could be resolved only if the defendant admitted the facts constituting the violation, or was found liable by a court or jury, there would be far fewer settlements, and much greater delay in resolving matters and bringing relief to harmed investors.

As articulated by Khuzami and the SEC brief, the agency is confident that its practices regarding "neither admit nor deny" settlements are consistent with and supported by those of other federal agencies and previous court decisions and that its settlement practice is a matter of good public policy. If Citigroup is the barometer, then defendants in similar circumstances clearly agree with the SEC. Without the benefit of the district court's brief, it is difficult to assess the strength of the parties' arguments, but it seems defendants can take comfort in the fact that little will change with the SEC's settlement practice notwithstanding an order from the Second Circuit that a trial should be held. The Second Circuit is not expected to rule until at least September 2012. We will report on that ruling and continue to monitor other developments in this case.

Record-setting Case Poised to Further Alter Landscape of FCPA Claims

By Nicholas J. Nastasi and Amy L. Piccola

In August 2011, a jury in the Southern District of Florida convicted Joel Esquenazi and Carlos Rodriguez, former executives of Miami-based Terra Telecommunications Corp., of conspiracy to violate the Foreign Corrupt Practices Act ("FCPA"), substantive FCPA violations and money laundering associated with paying bribes to officials of Telecommunications D'Haiti ("Haiti Teleco"), Haiti's national telecommunications company. The indictment alleged that Esquenazi, Rodriguez and their co-conspirators paid over $890,000 in bribes to directors of Haiti Teleco in return for business advantages. The alleged bribes were recorded in Terra's books and records as "commissions" or "consulting fees" to shell companies in violation of the FCPA's books and records provisions. Esquenazi and Rodriquez were sentenced in October 2011. Esquenazi's 15-year sentence is the longest ever imposed in an FCPA case by two times.

Esquenazi's "Foreign Officials Defense"

The FCPA was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to "foreign officials" to assist in obtaining or retaining business. 15 U.S.C. § 78dd-2(a)(1). A "foreign official," as defined in the Act, is "any officer or employee of a foreign government or any department, agency or instrumentality thereof." 15 U.S.C. § 78dd-2(h)(2)(A). "Instrumentality" is not defined in the statute, leading a growing number of FCPA-defendants to challenge whether state-owned enterprises can be considered instrumentalities of a foreign government under the FCPA.

In the district court, Esquenazi argued that mere control or partial control or ownership of an entity like Haiti Telecom by a foreign government does not make the entity's employees foreign officials. The court rejected Esquenazi's argument, finding that the plain language of the FCPA and the plain meaning of "foreign official" are such that Haiti Teleco, which was 97 percent state-owned by the Central Bank of Haiti, could be an instrumentality of the Haitian government and that the directors of the company could therefore be foreign officials.

The Appeal

Esquenazi's record-setting case is now presenting the first opportunity for a court of appeals to weigh in on interpreting the term "foreign official." Esquenazi filed an appeal in the 11th Circuit challenging his convictions asserting, *inter alia,* that he is entitled to an acquittal on all FCPA-based counts because the term "instrumentality" in the FCPA should be construed to encompass only foreign entities performing governmental functions similar to departments or agencies. Esquenazi argues that the government's reliance on the premise that state-ownership or control of a business entity alone makes the entity an instrumentality is inconsistent with the language of the FCPA. Esquenazi's appeal is not only a case of first impression for the Court of Appeals for the Eleventh Circuit, but also presents the first time that *any* circuit court will review the government's broad definition of "foreign officials."

What's Next?

The Eleventh Circuit's decision in the *Esquenazi* appeal could coincide with forthcoming government guidance on the very terms at issue in the case. The DOJ announced on June 5, 2012 that pending guidance will address the terms "foreign official" and "instrumentality," as well as companies' compliance programs. It is unclear exactly when the guidance will be released, but it will shed further light on an area that has been plagued by ambiguity.

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

George W. Bodenger
215.972.1955
gbodenger@saul.com

Andrea P. Brockway
215.972.7114
abrockway@saul.com

Jennifer A. DeRose
410.332.8930
jderose@saul.com

Cathleen M. Devlin
215.972.8562
cdevlin@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

Abigail Roughton
973.286.6716
aroughton@saul.com

Courtney L. Schultz
215.972.7717
cschultz@saul.com

Gregory G. Schwab
215.972.7534
gschwab@saul.com

Chad T. Williams
302.421.6899
cwilliams@saul.com