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Corporate Guilt And Individual Innocence in Financial Fraud

Part Two of a Two-Part Article

By Robert J. Anello and Kostya Lantsman

Comparing the success of the Department of Justice (DOJ) in extracting guilty pleas from companies for violations of the Foreign Corrupt Practices Act (FCPA) with the DOJ's notable trial failures in FCPA matters brought against individuals is particularly instructive when we are discussing individual versus corporate criminal accountability, as we did in the first part of this article.

Dozens of companies have pleaded guilty to FCPA-related charges while only two — Harris Corporation in 1990 and Lindsey Manufacturing Company in 2011 — put the government to the test by going to trial. Charges against Harris Corporation were dismissed before it put on its defense. Lindsey Manufacturing Company was convicted at trial, but the trial judge vacated the conviction and dismissed the indictment for prosecutorial misconduct. *See* Robert J. Anello & Kostya Lantsman, Law v. Lore: The Lack of Judicial Precedent in FCPA Cases, 22 *Business Crimes Bulletin* 11 (2015), available at http://bit.ly/2h6I2g5.

Similarly, prosecutors' failure to evaluate fairly the strength of

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The Continuing Evolution of the False Claims Act

By Jonathan S. Feld, Jason M. Ross and Christina C. Brunty

The number of lawsuits brought under the False Claims Act (FCA), 31 U.S.C. § 3729 *et seq.*, continues to increase. In 2015 alone, relators filed over 600 *qui tam* complaints — and courts awarded over $3.5 billion — under the FCA. In these cases, the United States government is the real party in interest, while individual relators (also known as "whistleblowers") may bring a complaint on behalf of the government. Accompanying this growth are significant FCA decisions including, most recently, *Universal Health Services, Inc., v. United States, ex rel. Escobar*, 579 U.S. __ (2016), decided in June 2016. In *Escobar*, the U.S. Supreme Court: 1) examined the materiality requirement of the FCA; and 2) approved "implied" false certification as the basis for the FCA claim. Other important decisions continue to make their way through the courts.

Violating the Seal

On Dec. 6, 2016, in *United States ex rel. Rigsby v. State Farm* (580 U.S. ___ (2016)), the Supreme Court issued a unanimous decision resolving a circuit split over whether a case-dispositive sanction must follow when a relator violates the sealing provision of the False Claims Act. Before this decision, courts had not reached consensus on whether a relator who discloses facts about the lawsuit during the sealing period must be sanctioned with dismissal of the case. Under the FCA, a relator's complaint must remain under seal for at least 60 days. During this time, the United States may confidentially review the complaint and supporting evidence to decide whether to intervene and proceed as the primary plaintiff or to decline participation, allowing the relator to pursue its lawsuit as a private litigant. While the 60-day sealing period is a minimum, in practice, courts routinely allow the sealing period to be extended many times. As a result, *qui tam* cases can remain sealed for years while the defendants and relators await the government's decision on whether to intervene; in *Rigsby*, the government ultimately

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chose not to intervene, thus allowing the relators to pursue their FCA claims as private plaintiffs.

In *Rigsby*, insurance claims adjustors brought a *qui tam* action against State Farm Insurance Co. The relators alleged that in the aftermath of Hurricane Katrina, State Farm misclassified claims as resulting from flood damage — payable under the federally backed National Flood Insurance Program — rather than wind damage, which would have been payable privately by State Farm. The relators were originally represented by noted tobacco lawyer Dickie Scruggs. In representing the *Rigsby* relators, Scruggs violated the sealing order by providing reporters and a member of Congress with information about the lawsuit, in an effort to pressure State Farm to settle early. State Farm argued to the trial court that Scruggs's violation of the sealing order required mandatory dismissal of the lawsuit. The trial court declined to dismiss, holding that it had broad discretion to fashion an appropriate lesser sanction.

The U.S. Court of Appeal for the Fifth Circuit affirmed the trial court's denial of State Farm's motion to dismiss. The Fifth Circuit followed the U.S. Courts of Appeal for the Ninth and Second Circuits in adopting the *Lujan* test, which balances three factors to determine if the violation of a sealing order requires dismissal. The court considered: "1) the harm to the government from the violations; 2) the nature of the violations; and 3) whether the violations were made willfully or in bad faith." *Rigsby*, 794 F.3d at 470. While the Fifth Circuit found that Scruggs — but not the individual relators — acted in bad faith, the court also concluded that State Farm did not show significant harm to the government that resulted from the violation, although the government had declined to intervene.

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Notably, the United States argued against the sanction of dismissal. Brief for the United States as Amicus Curiae, *United States ex rel. Rigsby v. State Farm Fire Cas. Co*. (No. 15-513). Specifically, the court noted that the news media did not publish information about the lawsuit before the seal was lifted. Thus, in spite of the leaks, the United States was able to assess the lawsuit in relative confidentiality during the pendency of the seal.

The Supreme Court affirmed the Fifth Circuit's decision, rejecting the *per se* or "automatic" approach adopted by the Sixth Circuit: that *any* violation of the sealing order requires dismissal, even with no showing of harm. *United States ex rel. Summers v. LHC Grp., Inc.*, 623 F.3d 287, 296-298 (2010). The Court held that, in enacting the FCA, Congress did not mandate automatic dismissal as a deterrent to leaks during the sealing period.

Petitioner State Farm further asked the Court to address what factors district courts must consider before imposing a sanction, including the sanction of dismissal. Indeed, a bulk of the Nov. 1, 2016 oral argument focused on addressing the parties' proposed standards to govern the imposition of sanctions. Ultimately, the Supreme Court declined to direct district courts as to what factors they must weigh in their analysis. Rather, the Court held that the standards applied "can be discussed in the course of later cases." *Rigsby*, 580 U.S. __, __ (2016) (slip op., at 10). The Court further held that the imposition of dismissal, or lesser sanctions, is within the sound discretion of the district courts, and will only be reviewed for plain error.

The Court declined to require automatic dismissal to deter leaks, but did note that sanctions short of

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Fallout from the 'Panama Papers'

Coming to a Courthouse Near You?

Part One of a Two-Part Article

By Stanley S. Arkin and Robert C. Angelillo

Among the first things we learn as defense attorneys is to keep informed and alert about events that may spawn or affect actions taken by prosecutors. We discuss herein an event, somewhat understated in this country, which, in our view, could lead to a host of criminal cases, both state and federal. This article sets forth an example of how one stays sensitive to what may be happening in the closed venues of prosecutors' offices.

The 'Panama Papers'

When the "Panama Papers" story burst onto the scene last spring, it sent shock waves through the halls of power in more than one country and international institution. Numerous resignations and prosecutions of foreign leaders and dignitaries resulted from the revelations in the Panama Papers. But is that the end of the story? Has the damage been contained? Not in the least. The fallout may just be beginning, and it may well land in a courthouse near you.

The "Panama Papers" is the name given to an investigation of more than 11.5 million documents that were released by a whistleblower to the German Newspaper Süddeutsche Zeitung (SZ) last spring. The released documents contained confidential financial and legal documents maintained by the Panamanian law firm Mossack Fonseca. That firm had long specialized in the creation of offshore entities and accounts for its largely international clientèle. The Panama Papers document dump contained information concerning no less than hundreds of thousands of offshore entities that the law firm had created on behalf of its clients over the years, no doubt including many United States citizens.

According to published reports, the Panama Papers documents were received by SZ in 2015, but SZ was overwhelmed by the sheer size of the production. Accordingly, to assist it in analyzing what it had been given, SZ distributed the documents to an organization known as the International Consortium of Investigative Journalists (the ICIJ), which examined the documents to determine the identity of those clients. The ICIJ is a collection of more than 150 investigative journalists from around the world whose stated mission is to expose international crime and corruption, including, but not limited to, corruption by the world's ruling elite. The ICIJ studied the Panama Papers and determined the identity of many of the firm's wealthy clients, who had created offshore accounts.

Stage 1: Fallout — Public Disgrace and Resignation of Foreign Public Officials

As has been well-reported, some of the initial fallout from the Panama Papers revelation was the public disgrace and resignation of a number of foreign government officials and prominent persons. For example, the Icelandic Prime Minister Sigmundur David Gunnlaugsson was pressured to resign after it was revealed that he and his wife had set up a shell company in the British Virgin Islands, which led to allegations of conflict of interest and tax evasion. Shortly thereafter, the Spanish Industry Minister, José Manuel Soria, was also forced to resign after the revelation from the Panama Papers investigation that he kept some of his money in a secret offshore account in the Bahamas.

Stage 2: Fallout — Tax Avoidance Investigations

One of the primary goals of establishing an offshore account of this nature is domestic tax avoidance. Offshore companies can be opened and operated in "tax havens," such as the British Virgin Islands and the Cayman Islands, and can be a vehicle to hide assets from, among others, the taxing authorities.

Although "tax haven" is not a strictly defined term, in general a "tax haven" is a jurisdiction where banks and financial institutions are permitted to operate with few (if any) questions from the authorities concerning the source of the depositor's money. Those banks' customer bases are usually from outside of the jurisdiction, and the jurisdiction itself usually provides for a low tax rate.

Since the "tax haven" banks are permitted to keep customer accounts shrouded in mystery, these accounts are ideal places to park money outside the view and reach of the taxing authorities of the depositor's home countries. Not surprisingly, in the wake of the release of the Panama Papers, many countries, including Australia, Argentina and the United Kingdom, announced that they were opening tax avoidance investigations. Those investigations are ongoing and likely will be for some time.

Shortly after the release of the Panama Papers, the United States Attorney for the Southern District of New York opened its own investigation of the reportedly more than 240 U.S. citizens who were identified in the papers for potential tax avoidance, a small percentage of the hundreds of thousands of Mossack Fonseca clients noted by the ICIJ. The precise subject of this investigation has not been fully disclosed, but, as discussed below, there may be issues other than tax avoidance under investigation.

Contributing to the absence of a large spate of United States tax avoidance prosecutions is the application of the United States' Foreign Account Tax Compliance Act (FATCA) of 2010. That law, passed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE)

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Act, includes numerous requirements designed to reduce tax evasion by U.S. citizens and companies and has been effective in building a wall around U.S. citizens attempting to avoid U.S. taxes.

Under FATCA, certain U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS on Form 8938, Statement of Specified Foreign Financial Assets. There are serious penalties for not reporting these financial assets (as described herein). This FATCA requirement is in addition to the long-standing requirement to report foreign financial accounts on FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) (formerly TD F 90-22.1). http://bit.ly/2h3uzCT.

Further, FATCA contains the reciprocal requirement for the foreign banks:

> FATCA will also require certain foreign financial institutions to report directly to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The reporting institutions will include not only banks, but also other financial institutions, such as investment entities, brokers, and certain insurance companies. Some non-financial foreign entities will also have to report certain of their U.S. owners.

Id.

We will discuss further potential consequences of the Panama Papers in next month's newsletter.

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cases against individuals or choosing to ignore their weaknesses has led to significant failures at trial, including the now infamous African sting cases, which involved charges against individuals under the FCPA.

In that failed prosecution, the government arrested and charged 22 individuals after a two and a half-year undercover investigation. That investigation involved FBI agents posing as Gabonese government officials willing to accept bribes from defense companies seeking contracts to sell body armor, weapons and other military gear to Gabon. Although three individuals pleaded guilty, 19 defendants refused to do so. The initial trial of four defendants ended in a mistrial due to a hung jury. The second trial, involving six more defendants, concluded with three acquittals, and the jury hung as to the other three defendants. Having failed to secure any convictions across two trials, the DOJ not only decided against retrying any of the counts where the juries failed to reach a verdict, but also dismissed all remaining charges and defendants.

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The government's case had … holes from the start, including credibility problems for its chief witness and evidence showing that most of the defendants … had never met or spoken to each other.

The government's case had significant holes from the start, including credibility problems for its chief witness and evidence showing that most of the defendants — the alleged conspirators — had never met or spoken to each other. Such public failures sensibly make prosecutors loathe to indict others unless their cases are airtight.

Recent Case Study

FX Manipulation

This past spring, the United Kingdom's Serious Fraud Office (SFO) announced that it was closing its investigation into fraudulent conduct related to the manipulation of FX rates without indicting any individuals. The SFO has not shied away from prosecuting individuals in the past — with mixed results. The SFO secured a guilty verdict against Tom Hayes of UBS and Citigroup for his attempts at rigging the London Interbank Offered Rate (LIBOR), while six brokers who had been accused of conspiring to help him were acquitted in a subsequent trial. It also secured guilty verdicts against three former Barclays employees for their roles in the LIBOR scandal, but the jury hung regarding the guilt of two other Barclays traders.

The SFO's decision not to prosecute any FX traders in the later FX manipulation scandal — coming on the heels of the acquittal of the six brokers in their LIBOR rigging trial and before the mixed results of the Barclays LIBOR trial — is instructive. Financial institutions have not only paid over $10 billion in fines and penalties, including over $2 billion to the UK regulator, to settle various charges related to FX manipulation, but Citicorp, JPMorgan, Barclays, and Royal Bank of Scotland pleaded

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Criminal Allegations Threaten Merger

Abbott Laboratories' $5.8 billion proposed purchase of Alere, a Massachusetts medical testing company, is in trouble now that multiple criminal allegations have been leveled against Alere. Abbott, apparently now reluctant, reportedly offered Alere around $50 million to release it from its agreement. Alere declined the offer, then claimed in an August 2016 suit that Abbott was dragging its feet due to a severe case of buyer's remorse.

The problems appear to stem from several legal actions now threatening Alere. The first sign of trouble came on Feb. 26, 2016, when Alere announced that it would delay the filing of its annual 10-K form with the U.S. Securities and Exchange Commission (SEC) because of concerns over its revenue recognition practices in Africa and China. The delayed form, finally filed in August 2016, contained little of major concern to the markets, but it did reveal the company's independent auditor's conclusion that Alere had not been maintaining effective internal controls over its financial reporting process. The company's August 2016 filing also showed revised financial results for fiscal years 2013, 2014 and three quarters of 2015.

That did not end Alere's troubles for the year, however, because the Department of Justice (DOJ) handed the company two criminal subpoenas, one related to sales on other continents and the other alleging violations of federal health care and anti-kickback laws. In addition, Alere and its subsidiary, Arriva Medical, are under investigation by the U.S. Attorney for the Middle District of Tennessee concerning possible improper claims submitted to Medicare and Medicaid.

Alere's complaint states that Abbott has made life a "living hell" by drowning it in a "sea of forensic-level informational" demands in an attempt to scuttle the merger. The claim, which seeks to compel consummation of the deal, is slated for a mediation hearing on Jan. 27 before former Delaware Chancery Court Chancellor William B. Chandler II.

Meanwhile, Abbott filed a breach of contract claim in November seeking information about Alere. In its 19-page complaint, the plaintiff asserts that "Abbott cannot acquire and operate Alere's businesses without timely, unfettered access to information regarding Alere's operations, finances, legal compliance and other aspects of its business." Further, it states, "Any acquirer of a business as large, complex and geographically diverse as Alere must be afforded full transparency in advance of closing."

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dismissal are available to protect the reputational damage FCA defendants may suffer when the seal requirement is violated. The Court specifically noted that even where dismissal is not appropriate, district courts are equipped with broad discretion to impose monetary penalties and attorney discipline.

Future cases will likely focus on developing a consistent set of factors district courts will employ to craft appropriate remedies. While the Supreme Court declined to mandate a specific set of factors, the Court did note that the *Lujan* factors used by the district court in *Rigsby* "appear to be appropriate." *Rigsby*, 580 U.S. __, __ (2016) (slip op., at 10).

As the lower courts continue to encounter these issues, FCA defendants will likely press for a test aimed at foreseeable harm, and not limited to the actual harm suffered by the government from the breach of the sealing order. Furthermore, FCA defendants will likely argue that courts should not rely exclusively on the Department of Justice's (DOJ's) view of the materiality of a violation. Framing the remedy in such a manner makes any dismissal decision depend on the government's specific interests in the case, which could vary with policy or political changes at the DOJ. Also, the United States, as the real party in interest, has a stake in any potential recovery. A standard that gives greater weight to whether the violation was made in bad faith — rather than a hindsight view of the harm actually done — would offer to relators a greater incentive against strategic "leaks" of information aimed at increasing settlement leverage.

Statistical Sampling Evidence in FCA Cases

A second False Claims Act issue making its way through the lower courts concerns the uses of statistical sampling. Relators, and the DOJ, use statistical analysis to show both the number of false claims and the extent of monetary loss by extrapolating from a sample of claims where the relator alleges a false statement is present. The technique has been used in health care cases and recent mortgage cases.

In *United States ex rel. Martin v. Life Care Ctrs. of Am.*, 2014 U.S. Dist. LEXIS 142657 (E.D. Tenn. 2014), the defendant, an operator of skilled nursing facilities, brought a *Daubert* challenge to exclude the use of statistical samples to extrapolate a total number of false claims, and estimated loss amount, associated with allegedly fraudulent billings. The government's expert used a sample of 400 patient admissions to extrapolate the number of improper claims and total overpayments for those patient admissions. The court found that the testimony was reliable under *Daubert* because the method used — statistical sampling and extrapolation — was well-supported and widely used in litigation; had been sufficiently published; was sufficiently precise; and was generally accepted in the scientific community.

Yet, this approach is not automatically acceptable, where the uniformity or consistency of the error is not established. In *United States ex rel. Michaels v. Agape Senior Community, Inc.*, 2015 U.S. Dist. LEXIS 82379 (D.S.C. 2015), the District

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Court of South Carolina reached a different conclusion. In that case, the relators, who alleged that the defendant nursing homes submitted fraudulent claims, wanted to use statistical sampling to extrapolate the number of claims and damages to over 50,000 individual claims. The court concluded that extrapolation evidence was inadmissible because proving falsity and the amount of loss on each claim was a highly fact-intensive inquiry, requiring medical testimony and an individual review of each patient and medical file.

On Oct. 26, 2016, the United States Court of Appeals for the Fourth Circuit held oral argument on the question of whether statistical sampling can be used to extrapolate the scope of liability. At oral argument, the Fourth Circuit appeared reluctant to rule upon the issue as a question of law, but viewed the appropriateness of any statistical evidence as best left to the trial court. Indeed, two Circuit Judges posed the question of whether the appeal should be dismissed as improvidently granted. In the event the Fourth Circuit declines to rule, health care providers will be left without concrete guidance regarding how statistical extrapolation of claims-related damages may be addressed in any individual case. Rather, defendants will continue to attack this methodology by way of *Daubert* challenges, leading to a growing catalog of decisions on each side of the issue.

Conclusion

The DOJ continues to use criminal and civil False Claims Act cases as a enforcement tool of choice in a wide range of industries. As shown in *Rigsby*, even a decision by the government not to intervene may not end the DOJ's presence in the case, as the government may seek to be the arbiter of whether a claim is dismissed for violations of the sealing provision. Moreover, use of statistical sampling by the government and private plaintiffs will continue to be an issue of concern for defendants, as it has the potential to dilute the burden of proof and allow a party to prove liability and damages without direct, claim-by-claim evidence of improper payments. Companies that engage in transactions with federal government programs should remain vigilant about these developments and their effects on potential liability.

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guilty to U.S. criminal charges for conspiring to manipulate the FX market. Yet, the SFO announced its conclusion that "there is insufficient evidence for a realistic prospect of conviction" of any individuals. Although the DOJ has made no such announcement, and may yet bring charges, no such charges for FX manipulation have been filed well over a year after guilty pleas by the various banks.

Although the SFO has pointed to "insufficient evidence" — a common justification for failing to bring individual prosecutions — the circumstances reveal that the SFO has evidence to show exactly what happened. According to the DOJ press release, traders from various banks "used an exclusive electronic chat room and coded language to manipulate benchmark exchange rates." The information was not exchanged in dark alleys, the actions did not take place behind locked doors and the agreements were not hatched using hushed tones at the local pub. Instead, traders carried out their communications and made their agreements in imprudently named chat rooms such as "The Cartel," "The Bandits' Club" and "The Mafia." The financial institutions captured and turned over these communications, revealing the precise words and actions of the traders involved. Thus, the SFO concluded not that it failed to gather evidence for sufficient proof of what happened, but that the evidence did not show that individuals were criminally liable.

Moreover, the fact that the banks pleaded guilty to criminal charges supposedly based on the evidence gathered suggests either: 1) that the banks' guilt was a result of the collective knowledge, intent, and acts of its officers rather than criminal wrongdoing by any particular individual or individuals; or 2) that the banks pleaded guilty simply to put the FX manipulation matter behind them.

What Will Be the Impact of the Yates Memorandum?

Responding to repeated calls to prosecute more individuals, the DOJ, through the Yates Memorandum, has attempted to leverage the corporation and its lawyers to help it pursue individuals. Experienced prosecutors and defense attorneys can attest that prior to the Yates Memorandum, individuals were not ignored — rather, prosecutors have always asked, and defense attorneys have answered, the hard questions as to whether or not to bring such cases against individuals.

For a corporation that knows that it must settle a criminal investigation, the goal is to minimize the penalty of that settlement by cooperating with prosecutors. The purpose of the Yates Memorandum was to enlist the corporate counsel to focus on individuals when performing investigative work in order to help the DOJ achieve individual convictions. The first, and arguably most important, guidance in the Yates Memorandum is that "[t]o be eligible for any cooperation credit, corporations must provide to the [DOJ] all relevant facts about the individuals involved in corporate misconduct." The corporation "must identify all individuals

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IN THE COURTS

$92 Million Jury Verdict For Allied Home Mortgage

A jury in the Southern District of Texas awarded over $92 million in damages to the United States in a case against mortgage lenders who fraudulently granted and underwrote loans insured by the Federal Housing Authority and then reaped massive payouts when those loans went into default. Allied Home Mortgage Capital Corporation (Allied Capital), Allied Home Mortgage Corporation (Allied Corporation) and the President and CEO, Jim Hodge, were found liable of both FCA and FIRREA charges after a five-week trial in Houston. Hodge is personally liable for over $7 million of the judgment.

The Allied entities and Hodge could potentially pay much more, though, as damages awarded for violations of the FCA can be trebled. In addition, the court still must determine mandatory penalties for each violation under the FCA and FIRREA. Each violation of the FCA carries a penalty range of $5,500 to $11,000.

The charges were originally filed in 2011 in the wake of the 2008 recession. The case began as a whistleblower action by a Massachusetts branch manager. In its initial claim, the government claimed that Allied had a default rate of 32% on its loans from 2001 to 2010, and a rate of default of 55% in 2006 and 2007. The government alleged it had paid over $830 million dollars under its FHA insurance policy based on these defaults. During this time, Allied was one of the nation's largest private mortgage lenders.

The Federal Housing Authority (FHA) provides mortgage insurance to lenders in order to protect them in the case of default and to enable them to sell their loans in the marketplace. In order to be eligible for this coverage, the Department of Housing and Urban Development (HUD) must certify that the lenders are following proper practices in issuing loans and are subject to oversight. This is to ensure that lenders are not issuing overly risky loans in order to unfairly reap insurance benefits when default occurs.

Allied Capital was approved by the HUD to grant loans insured by the FHA, and had hundreds of branches across the country. Some of these branches, however, operated as what the Department of Justice (DOJ) referred to as "shadow" branches. These unregistered branches issued loans insured by the FHA, despite the fact that they were not registered with the government and had not received approval to issue FHA-backed loans. In order to ensure that FHA insurance would cover loans issued by these branches, the company falsified the loan agreements to appear as if they had been granted at approved branches. The federal government had no way to oversee these "shadow" branches, and was unable to monitor the rate of defaults occurring at these branches.

Allied Corporation was part of the Direct Lender Program and would underwrite loans insured by the FHA. It was required to verify that every FHA-insured loan it underwrote complied with the guidelines set by HUD to ensure that the loan could be repaid. Despite this, Allied Corporation ultimately approved over 1,000 FHA-insured loans that did not meet the HUD Guidelines, and when many of these loans defaulted, HUD lost more than $85.6 million.

In addition to these violations, Hodge instructed employees to falsify documents related to its compliance with government requirements, including quality control audit reports and certifications to HUD.

"For years, Jim Hodge and Allied lied to HUD in order to fraudulently reap profits from the FHA mortgage insurance program," said Preet Bharara, Manhattan U.S. Attorney. "This case represents yet another recovery by the United States — this time after a trial — for fraud perpetrated against HUD by participants in the Direct Endorsement Lender program."

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In the Courts and Business Crimes Hotline were written by **Katherine Monks**, an associate at Mayer Brown, Washington, DC.

BUSINESS CRIMES HOTLINE

NEW YORK

'Sons and Daughters Program' Costs JP Morgan

On Nov. 17, 2016, JPMorgan APAC, a Hong Kong subsidiary of JP Morgan Chase & Co., agreed to pay $72 million for violations of the Foreign Corrupt Practices Act (FCPA) resulting from its practice of awarding jobs and internships to individuals referred by Chinese government officials in order to secure business deals in return. Referred to as the "Sons and Daughters Program," this practice was created by JPMorgan APAC to gain business from state-owned companies, and resulted in roughly $35 million in contracts to JPMorgan APAC. In total, JP Morgan and JPMorgan APAC will pay over $264.4 million in penalties and fines for this *quid pro quo* hiring initiative.

The FCPA prohibits giving "anything of value" to foreign officials in order to influence their decisions or gain or retain business. "Awarding prestigious employment opportunities to unqualified individuals in order to influence government officials is corruption, plain and simple," said Assistant Attorney General Leslie R. Caldwell. She continued, "[t]his case demonstrates the Criminal Division's commitment to uncovering corruption no matter the form of the scheme."

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In addition to hiring often under-qualified referred individuals with connections to clients and/or government officials for jobs and internships, JPMorgan APAC also funded special positions for individuals who could not obtain employment due to their lack of qualifications. In one instance, JP Morgan's New York office refused to hire a candidate referred to them by a senior executive of a client planning an IPO. The New York office explained that the candidate was under-qualified compared with his peers, and that it could not offer him a position. Despite this, JPMorgan AMAC funded a special year-long position for the individual in the New York office. After that, JPMorgan APAC was chosen to help represent the client in its IPO deal and received almost $24 million for doing so.

Moreover, for individuals who could not receive a spot in the traditional paid internship program offered by the company, JPMorgan APAC created a special, unpaid summer training program in Hong Kong for client-referred candidates. Participants were selected solely based on their connections with current and potential clients, which were often state-controlled entities.

This *quid pro quo* system occurred from about 2006 to 2013. During that time JP Morgan had an internal Compliance Questionnaire specifically for potential hires under the Sons and Daughters Program that was meant to avoid any FCPA violations from the practice. The questionnaire sought to determine how the applicant had been hired, how he or she was connected to potential or existing clients and government officials, and whether the company stood to gain anything from the offer of employment. However, despite this system, JPMorgan APAC would often provide false information in the questionnaire to ensure that its chosen candidates were successful, regardless of potential conflicts of interest. In 2009, despite the presence of the Compliance policy, the company emphasized that individuals given positions under this program must have "directly attributable linkage to business opportunity."

Ultimately, JP Morgan APAC paid a penalty of $72 million to the DOJ and a $130.5 million disgorgement to the SEC for violations of the FCPA. In addition to the DOJ and SEC settlements, the Federal Reserve Board also levied a civil fine against JP Morgan APAC in the amount of $61.9 million for "unsafe and unsound practices" based on the Sons and Daughters Program. Notably, the Federal Reserve Board is not able to enforce the FCPA, nor has it ever assessed a penalty for an FCPA violation in the past. Its decision to do so in this case represents a new source of potential liability for companies that violate the FCPA.

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involved in or responsible for the misconduct."

Furthermore, the Yates Memorandum instructed DOJ prosecutors "not [to] resolve matters with a corporation without a clear plan to resolve related individual cases," and that "absent extraordinary circumstances or approved [DOJ] policy, the [DOJ] will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation." Thus, corporate defense attorneys know that the fastest way to resolve an investigation is not only to cooperate by providing evidence against the corporation, but also to provide the evidence and assistance necessary for DOJ investigators to formulate a plan on resolving individual cases through civil or criminal charges or settlements.

The Yates Memorandum may not materially alter the landscape. For the last several decades, corporate cooperation has been the norm, not the exception. Because of the high hurdles involved in successfully prosecuting individuals, the Yates Memorandum's renewed focus on holding individuals accountable may make little difference in achieving convictions of individuals in white collar cases. Although the Yates Memorandum ostensibly will further incentivize companies to help prosecutors to investigate and understand the roles of individuals, it does not change the requisite elements of individual criminal liability nor alter the motives for real people to doggedly fight being labeled a criminal. Nor should it affect a sensible prosecutor's careful weighing of the evidence and evaluating the government's chances of developing a case beyond a reasonable doubt.

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Thus, despite this greater focus on holding individuals accountable, innocent executives, represented by capable counsel, are no more likely to be prosecuted successfully or convicted today than in the past.

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