

Quarterly FCPA Report: Fourth Quarter 2011

BY THE GLOBAL COMPLIANCE AND DISPUTES PRACTICE

I. Introduction

The fourth quarter brought to a close one of the most active years in the history of Foreign Corrupt Practices Act enforcement. The U.S. Department of Justice ("DOJ") continues to aggressively prosecute violators in the courtroom, as evidenced by the historic fifteen-year prison sentence handed down against Joel Esquenazi, convicted principal in the Haiti Teleco case. Outside of the courtroom, the DOJ and the U.S. Securities and Exchange Commission ("SEC") reached settlements expected to total more than \$75 million in criminal fines. Three companies also disclosed that the DOJ and SEC had commenced FCPA related investigations, namely Halliburton, Avon, and Embraer. The government scrutiny of corporate activities has incentivized companies to be proactive in exposing corruption, and the fourth quarter saw several major corporations, including Walmart, Avon, and Analogic, announce internal investigations focused on uncovering violations of the FCPA.

The government also intensified its efforts in pursuing not just corporate offenders, but the individual actors responsible for FCPA violations. In the fourth quarter, the DOJ indicted eight former executives of Siemens AG for their alleged roles in an illegal payment scheme and won a thirty-month prison sentence for former Innospec agent, Ousama Naaman. The government also had a significant victory in December, when the Second Circuit Court of Appeals upheld the conviction of Frederick Bourke for conspiracy to violate the FCPA for Bourke's role in a scheme to purchase a state-owned oil company in Azerbaijan through illicit payments to Azeri government officials.

The government's zeal in pursuing FCPA cases has not gone entirely unimpeded. The May 2011 convictions the government won in the Lindsey trial were heralded at the time as significant victories, but in November, a federal district court dismissed the indictments against the executives, citing misconduct by federal prosecutors in conducting the investigation and prosecution. Similarly, the government filed a motion to dismiss charges against Si Chan Wooh, in spite of a previous guilty plea, due in part to concerns over the handling of the case. Finally, in December, the government had a significant set-back in its prosecution of the Arms Contract Case, the large-scale undercover investigation in which federal agents posed as a foreign minister of defense in order to uncover illicit payments being made in exchange for contracts. A federal judge acquitted Stephen G. Giordanella, an alleged principal in the case, for failure to prove beyond a reasonable doubt that Giordanella participated in an overarching conspiracy. These legal obstacles for the government in the fourth quarter may signify that courts are beginning to push back against the tactics used to pursue FCPA violators. This will no doubt be an important trend to follow in the coming year.

Overall, this quarter saw a wide variety of enforcement actions. For corporate defendants, this included three SEC settlements, two of which resulted in a deferred prosecution agreement and a non-prosecution agreement with the DOJ. For individuals, there were three prison sentences handed

down, as well as indictments issued in one case against eight former executives. Five individuals had charges against them dismissed, while one had his conviction upheld by the Court of Appeals.

II. Enforcement Actions Against Individuals

A. Keith Lindsey, Steve Lee, and Angela Aguilar – Indictments/Conviction Dismissed

On November 29, 2011, Federal District Judge Howard Matz dismissed with prejudice the indictment against executives Keith Lindsey, Steve Lee, and Lindsey Manufacturing. In a final order released December 1, 2011, Judge Matz detailed a laundry list of violations by federal prosecutors, noting that “the Government team allowed a key FBI agent to testify untruthfully before the grand jury, inserted material falsehoods into affidavits submitted to magistrate judges in support of applications for search warrants and seizure warrants, improperly reviewed e-mail communications between one Defendant and her lawyer, recklessly failed to comply with its discovery obligations, posed questions to certain witnesses in violation of the Court’s rulings, engaged in questionable behavior during closing argument and even made misrepresentations to the Court.” Judge Matz described the government’s investigation as “sloppy,” “incomplete” and “overzealous,” and expressed “deep regret” that he was compelled to dismiss the indictments.

In May 2011, the Lindsey executives were convicted of conspiring to violate the FCPA and substantive FCPA violations for their role in making unlawful payments to officials at Mexico’s state-owned electric utility, Comisión Federal de Electricidad (“CFE”). The original jury verdict came after only one day of deliberation and the Lindsey executives faced a potential thirty-year prison sentence. At the time, the conviction was hailed as a significant victory for the DOJ.

The dismissal with prejudice means that the government will not be able to bring another case against the Lindsey executives based on the same offenses. The government’s only remaining remedy is an appeal to the U.S. Court of Appeals for the Ninth Circuit.

Following the dismissal of the indictments, the government agreed to vacate Angela Aguilar’s conviction, pending its appeal of the order to dismiss. Aguilar and her husband allegedly laundered money used for illicit payments to an official of CFE, on behalf of Lindsey Manufacturing. Mrs. Aguilar was charged with conspiracy to launder money and was convicted last May. Should the government’s appeal fail, her conviction will be set aside.

B. Stephen G. Giordanella, Arms Contract Case – Acquittal/Dismissal

On December 22, 2011, Federal District Judge Richard Leon acquitted Stephen G. Giordanella of conspiracy to violate the FCPA following a twelve-week jury trial in U.S. District Court for the District of Columbia. Giordanella was one of 22 defendants indicted in 2009 as part of the Arms Contract Case in which FBI agents conducted an undercover investigation involving an alleged scheme to make illicit payments to the minister of defense for the country of Gabon. The government alleges that the defendants agreed to pay a 20% “commission” to an agent believed to be a representative of the minister of defense in order to secure part of a \$15 million contract to supply Gabon’s presidential guard with military equipment.

Judge Leon found that “viewing the evidence in the light most favorable to the Government, the Court does not believe the Government has produced sufficient evidence to enable a rational trier of fact to conclude beyond a reasonable doubt that each of these six defendants participated in the overarching conspiracy charged in the superseding indictment in this case.” Since Giordanella was only charged with the conspiracy, the ruling represented a full acquittal. The conspiracy charge was also dismissed against five other defendants who still face charges on the substantive FCPA violations.¹

C. Siemens AG: Uriel Sharef, Herbert Steffen, Andres Truppel, Ulrich Bock, Stephan Signer, Eberhard Reichert, Carlos Sergi, and Miguel Czysch – Indicted

On December 13, 2011, the DOJ announced that eight former executives and agents of Siemens AG had been indicted for allegedly making illegal payments in excess of \$100 million to Argentine officials in order to secure a \$1 billion contract to produce national identity cards (“DNI Project”). The Siemens executives and agents face charges of criminal conspiracy to violate the FCPA, conspiracy to commit wire fraud, conspiracy to commit money laundering and substantive wire fraud.

The indictment comes three years after Siemens AG reached a settlement with the DOJ and SEC totaling \$800 million for violating the internal controls and books and records provisions of the Foreign Corrupt Practices Act. Assistant Attorney General Lanny Breuer commented that “[t]his indictment reflects our commitment to holding individuals, as well as companies, accountable for violations of the FCPA.”

According to the indictment, during the bidding and implementation phase of the DNI Project the Siemens defendants pledged approximately \$100 million in illegal payments to Argentine government officials, members of the opposition party and candidates for office that were likely to come to power during the lifetime of the project. These illegal payments were actively concealed in various manners, including deposits and withdrawals from Swiss bank accounts, disguised wire transfers and the use of seventeen off-shore shell companies for the purpose of laundering funds. In May 1999 when the project was suspended, the defendants committed additional funds to the incoming administration to reinstate the contract. Finally, in May 2001 when the project was terminated, the defendants participated in a scheme to recover the funds through a fraudulent arbitration, including tampering with witness statements and filing false pleadings.

The DOJ noted that the charges against the Siemens defendants arise from the “laudable” activities of Siemens AG and its audit committee, and their commitment to discovering and disclosing potential FCPA violations. Following the settlement in 2008, Siemens AG engaged in an internal investigation of “unprecedented scope” and “cooperated extensively and authentically” with the DOJ in resolving ongoing investigations.

D. Joel Esquenazi and Carlos Rodriguez – Sentenced

On October 25, 2011, the DOJ announced that Joel Esquenazi, a principal in the Haiti Teleco case, had been sentenced to fifteen years in prison, the longest FCPA prison sentence in history. Carlos Rodriguez, another principal in the case, was sentenced to seven years in prison.

Esquenazi and Rodriguez were formerly president and executive vice president, respectively, of Terra Telecommunications Corp. On August 4, 2011, the pair was found guilty of conspiracy to violate the FCPA and conspiracy to launder money, wire fraud, seven counts of FCPA violations and twelve counts of money laundering. These charges stemmed from their role in a scheme to make illegal payments to government officials at Haiti Teleco. Between 2001 and 2005, Esquenazi and Rodriguez conspired and made corrupt payments of over \$800,000 using shell companies to facilitate the payments and falsely recording these payments as remittance for “consulting services.” According to court documents, these payments were made to obtain favorable telecommunications rates and to encourage the continuance of Terra Telecommunications’ connection with Haiti.

Esquenazi and Rodriguez will also be required to forfeit \$3.09 million of profit collectively. Assistant Attorney General Lanny Breuer commented that the historic sentence “is a stark reminder to executives” that violating the FCPA “is a serious crime with serious consequences,” and that “we will continue to hold accountable individuals and companies who engage in such corruption.”

E. Ousama Naaman – Sentenced

On December 22, 2011, Ousama Naaman, former agent for Innospec Inc. in Iraq, was sentenced to 30 months in prison and a \$250,000 fine for his role in a conspiracy to defraud the United Nations Oil-for-Food Programme and to violate the anti-bribery and books and records provisions of the FCPA by making illicit payments to Iraqi officials.

Last year Naaman pleaded guilty to conspiracy and to violating the FCPA. In March 2010, Innospec, Inc. reached a \$40 million global settlement with authorities in the U.S. and U.K. for FCPA and U.N. Oil-for-Food Program violations. In Naaman's guilty plea, he admitted paying or promising to pay more than \$3 million in kickbacks to officials in Iraq's Ministry of Oil and the Trade Bank of Iraq in order to obtain business for Innospec.

Naaman was originally indicted in August 2008 and was charged with one count of conspiracy to commit wire fraud and to violate the FCPA, and two counts of violating the FCPA. The superseding indictment later dropped the wire fraud conspiracy charge. Naaman was arrested on July 30, 2009 in Frankfurt, Germany and was extradited to the United States. To date, Naaman is the only individual involved in the Innospec actions to be prosecuted in the United States.

F. Frederick Bourke – Conviction Upheld

On December 14, 2011, the Second Circuit Court of Appeal upheld the conviction of Frederick Bourke on charges of conspiracy to violate the FCPA. Bourke was found guilty in July 2009 of participating in a scheme with Victor Kozeny and others to purchase an Azerbaijan-owned oil company ("SOCAR"), in part by making illicit payments to the Azeri President and other government officials.

Bourke had challenged his conviction on several grounds, most notably that the district court erred in its instructions to the jury on "conscious avoidance" as part of the knowledge element for FCPA liability. The court of appeals held that there was the necessary factual predicate for an instruction on "conscious avoidance," given that there was sufficient evidence presented at trial that Bourke knew of the pervasiveness of corruption in Azerbaijan, that he shielded himself from knowledge of the direct activities of his shell companies operating in Azerbaijan and that he questioned whether illegal payments were being paid in a recorded phone conversation. "Taken together," the court held, "a rational juror could conclude that Bourke deliberately avoided confirming his suspicions . . . [and] this same evidence may also be used to infer that Bourke actually knew about the crimes."

In a related decision, on December 15, 2011, U.S. District Court Judge Shira Scheindlin denied Bourke's motion for a new trial. Bourke had argued that the government's key witness, Hans Bodmer, had offered perjured testimony at the original proceeding. Judge Scheindlin denied the motion based on the fact that while Bodmer may have been mistaken about the time and date of the meeting with Bourke to which he testified, the jury could still credit the substance of the testimony.

G. Si Chan Wooh – Charges Dropped

On October 14th, the DOJ filed a motion to dismiss charges against Si Chan Wooh, former Executive Vice President of Schnitzer Steel Industries Inc., for conspiracy to violate the FCPA. In June 2007, Wooh pleaded guilty for his role in facilitating \$200,000 in illicit payments to Chinese managers on behalf of Schnitzer. The payments were intended to induce the purchase of scrap metal from Schnitzer, who allegedly made a nearly \$6 million profit from the sales.

Despite Wooh's guilty plea, concerns over how the case was being handled led to a May 2010 letter from FBI Special Agent Joe Lamonica to Denis McNerney, the Chief of the Criminal Division's Fraud

Section, recommending that the DOJ dismiss the charges. Lamonica detailed his belief that Wooh had been unaware that the commission payments he was facilitating were actually illegal payments. Lamonica also stated that he considered Wooh to be a whistleblower who had assisted in uncovering Schnitzer's illicit activities.

In making the motion to dismiss, the government cited "prosecutorial discretion in the interests of justice and the efficient use of government resources." Wooh could have faced up to five years in prison for his role in the scheme, although prosecutors had stated they would only seek probation and no jail time.

III. Recent Corporate Enforcement Actions

A. Magyar Telecom Plc of Hungary – SEC and DOJ Settlement

On December 29, 2011, the DOJ and SEC announced that they had reached an agreement with Magyar Telecom Plc ("Magyar") and its majority owner, Deutsche Telekom AG, to resolve FCPA criminal and civil allegations. Magyar will pay \$31.2 million to the SEC and \$59.6 million to the DOJ, with Deutsche Telekom paying an additional \$4.36 million to the DOJ. The DOJ filed a criminal information against Magyar and a two-year deferred prosecution agreement in the U.S. District Court for the Eastern District of Virginia.

The SEC also sued three former Magyar executives for FCPA violations, seeking disgorgement and civil penalties. The executives allegedly used sham consulting and marketing contracts to disguise improper payments in the amount of \$6 million to Macedonian officials. The payments were intended to prevent the introduction of a new competitor into the market and to gain regulatory benefits. The sham contracts were recorded as legitimate in both Magyar and Deutsche Telekom's financial statements. The same executives also orchestrated a second scheme in Montenegro, making \$9 million in improper payments in connection with Magyar's acquisition of a state-owned telecommunications company.

The settlement is the ninth-largest corporate enforcement action in the history of the FCPA.

B. Watts Water Technologies, Inc. and Leesen Chang – SEC Settlement

On October 13, 2011, the SEC issued an administrative order and accepted a settlement with Watts Water Technologies, Inc. ("Watts") and Leesen Chang, former Vice President of Sales for Watts China, related to alleged payments by Watts and third parties to employees of Chinese design institutes. Watts agreed to pay \$2,755,815 in disgorgement, \$820,791 in prejudgment interest, and a \$200,000 penalty to settle the matter. Chang will pay a \$25,000 penalty.

The order noted that the SEC limited Watt's penalty due to the company's cooperation in the investigation and its remedial activities. In 2009, Watts undertook an internal investigation, which it promptly self-reported to the SEC and later provided periodic updates on its findings. In addition, Watts initiated wide-ranging remedial measures including drafting and implementing several enhanced anti-corruption procedures, ceasing all commission-based compensation during the investigation, conducting a worldwide anti-corruption audit, and conducting additional FCPA and anti-corruption training.

C. Aon – SEC and DOJ Settlement

On December 20, 2011, Aon Corporation, one of the largest insurance brokerage firms in the world, agreed to resolve FCPA charges with the DOJ and SEC. It will pay a \$1.76 million criminal fine to the DOJ and \$14.5 million in disgorgement and prejudgment interest to the SEC.

According to the non-prosecution agreement with the DOJ, Aon's U.K. subsidiary, Aon Limited, administered certain training and education funds in connection with its reinsurance business to Costa Rica's state-owned insurance company, Instituto Nacional De Seguros ("INS"). Aon allocated a portion of the brokerage commission on the INS account each year to the fund, purportedly to sponsor training and education trips for INS officials. From 1999 to 2002, at INS's request, Aon Limited managed a second training account funded by premiums paid by INS to reinsurers, who set aside 3% of the gross ceded premiums on reinsurance treaties for education and training. While these accounts were supposed to be used for the training of INS officials, significant portions of the funds were used for non-training activities, such as travel to overseas tourist destinations with spouses. Many of the records did not provide any legitimate business purpose for the expenses.

The SEC's complaint alleges that Aon's subsidiaries made over \$3.6 million in improper payments to various parties between 1983 and 2007 as a means of obtaining or retaining insurance business in those countries. The foreign government officials who allegedly received some of the improper payments were capable of awarding business directly to Aon subsidiaries or were in positions of influence over those who could award business. The complaint further alleges that these payments were not accurately reflected in Aon's records and that Aon failed to maintain an adequate internal controls system.

The DOJ entered the non-prosecution agreement with Aon and Aon Limited as a result of what the DOJ called "extraordinary cooperation." According to the DOJ, Aon's cooperation, combined with its early and extensive remedial efforts and a penalty previously paid by the U.K.'s Financial Services Authority, led to substantially reduced monetary penalties. In addition to the monetary penalty, the non-prosecution agreement requires that Aon adhere to rigorous compliance, bookkeeping and internal controls standards, and cooperate fully with the DOJ in resolving these matters.

IV. Conclusion

This quarter continued the trend of active FCPA enforcement, with the DOJ winning a historic prison sentence and reaching several settlements with high profile corporations. Though the sum total of corporate fines, penalties, and disgorgement may have dropped in 2011 (\$508.6 million, down from \$1.8 billion in 2010), the DOJ has aggressively pursued enforcement actions against individuals. While there has been some push back from the courts against the DOJ's tactics, the DOJ and the SEC continue to zealously pursue both corporate and individual violators of the FCPA.

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¹ John Mushriqui, Jeana Mushriqui, R. Patrick Caldwell, Marc Morales, and John Gregory Godsey still face charges on the substantive FCPA violations.