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Analogic and Johnson Controls Settlements Shed Further Light On The Implementation of DOJ's FCPA Pilot Program

The U.S. Department of Justice (“**DOJ**”) and the U.S. Securities and Exchange Commission (“**SEC**”) recently announced two FCPA settlements that shed further light on how the DOJ is implementing its FCPA “Pilot Program.”

The Pilot Program, which was announced by the DOJ on April 5, 2016, was intended to motivate companies to voluntarily self-disclose FCPA-related misconduct, fully cooperate with the Fraud Section, and, where appropriate, remediate flaws in their controls and compliance programs.¹ Under the Pilot Program, a company can receive up to a 50% reduction off the bottom end of the United States Sentencing Guidelines Fine Range if the company (1) voluntarily self-reports FCPA-related misconduct, (2) fully cooperates with the DOJ's investigation, (3) remediates flaws in the company's internal controls or anti-corruption compliance program and (4) disgorges ill-gotten profits.²

On June 21, 2016, the DOJ announced that it had entered into a non-prosecution agreement (“**NPA**”) with a Danish subsidiary of Analogic Corporation (“**Analogic**”), BK Medical ApS (“**BK Medical**”), for engaging in an improper payments scheme with the principal Russian distributor of its ultrasound products in violation of the books and records provisions of the FCPA. On the same day, the SEC entered into a settlement with Analogic, alleging violations of the books and records and internal accounting controls provisions of the FCPA.

On July 11, 2016, the SEC announced that it had entered into a settlement with Johnson Controls, Inc. (“**JCI**”), a diversified technology and industrial services provider, for violations of the books and records and the internal accounting controls provisions of the FCPA, in connection with improper vendor payments carried out by employees at JCI's Chinese subsidiary, China Marine. On the same day, it was disclosed that the DOJ had declined to prosecute JCI for the same conduct.

¹ See U.S. DEP'T OF JUSTICE, The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan & Guidance (Apr. 5, 2016), <https://www.justice.gov/opa/file/838386/download> (the “**Memorandum**”).

² See Paul Weiss Client Memorandum, DOJ Announces a Pilot Program to Encourage Companies to Self-Report FCPA Violation (Apr. 6, 2016), <https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/doj%E2%80%99s-fraud-section-announces-a-pilot-program.aspx?id=21706>.

These resolutions provide further insight into how DOJ is implementing the Pilot Program and, specifically, underscore the importance of fully disclosing all relevant facts if a company chooses to self-report and avail itself of the Pilot Program.

A. BK Medical and Analogic Settlements

According to the settlement documents, from at least 2001 through early 2011, BK Medical engaged in an improper payment scheme involving its largest Russian distributor. Specifically, after the terms of a sale between BK Medical and a distributor had been agreed upon, BK Medical would issue invoices falsely inflating the sales price of the sold equipment at the request of its distributor. The distributor then overpaid BK Medical, which, in turn, transferred the excess payments to third parties as directed by the distributor. In total, as part of this scheme, BK Medical channeled approximately \$20 million in payments to various third parties, and concealed those payments by incorporating fictitious invoices into BK Medical's financials, which were ultimately incorporated into Analogic's books and records.³ In 2011, upon discovery of some of these transactions, Analogic began an internal investigation and voluntarily disclosed the questionable conduct to the DOJ and the SEC.

In addition to suspicious transactions in Russia, the settlement documents indicate that, to a lesser extent, there were also suspicious transactions to distributors in Ghana, Israel, Kazakhstan, Ukraine and Vietnam from December 2001 to early 2011. The arrangements followed the same structure as the transactions in Russia but the distributors' creation of fictitious documents varied in degree. BK Medical served as a conduit for at least 80 payments to third parties pursuant to arrangements with these other distributors, totaling approximately \$3.8 million. The SEC took the position that BK Medical's payment arrangements with its distributors created a significant risk that BK Medical was facilitating bribery or other prohibited conduct, such as embezzlement or tax evasion. The SEC has taken similar positions in other recent settlements, such as with BHP Billiton, where there appeared to be clear evidence of a risk of bribery, but not of actual bribery.⁴

³ See U.S. DEP'T OF JUSTICE, BK Medical ApS Non-Prosecution Agreement (June 21, 2016) ("**BK Medical NPA**"), <https://www.justice.gov/opa/file/868771/download>; U.S. SEC. & EXCHANGE COMM'N, In the Matter of Analogic Corp., Exchange Act Release No. 78113 (June 21, 2016), <https://www.sec.gov/litigation/admin/2016/34-78113.pdf> ("**Analogic SEC Settlement**").

⁴ In BHP Billiton ("**BHPB**"), the SEC reasoned that while BHPB recognized that inviting government officials to the Olympics created a heightened risk of violating anti-corruption laws, the internal controls BHPB developed and relied upon to address this risk were insufficient and therefore resulted in BHPB inviting government officials to the Olympics who were involved in or in a position to influence pending contract negotiations affecting BHPB. See *In the Matter of BHP Billiton*, Exchange Act Release No. 74998 (May 20, 2015), <https://www.sec.gov/litigation/admin/2015/34-74998.pdf> ("**BHP Billiton SEC Settlement**").

On June 21, 2016, it was announced that BK Medical and Analogic had entered into settlements with the DOJ and the SEC. Specifically, BK Medical agreed to enter into a non-prosecution agreement (“NPA”) with the DOJ and to pay a \$3.4 million criminal penalty for violating the books and records provision of the FCPA. Analogic also agreed to pay the SEC \$7.7 million in disgorgement and \$3.8 million in prejudgment interest to settle charges that it failed to keep accurate books and records and maintain adequate internal accounting controls. The total amount paid in connection with these settlements is approximately \$14.9 million.

According to the DOJ, in deciding to resolve this matter by an NPA, the DOJ considered that BK Medical had no prior criminal history, committed to continue enhancing its compliance program and internal controls and to continue cooperating with the DOJ and with “foreign authorities that are prosecuting individuals involved in this matter”. Although the self-reporting occurred prior to the announcement of the Pilot Program, the NPA makes clear that the DOJ nonetheless evaluated the resolution using the Program’s criteria. BK Medical received “full credit” for its voluntary disclosure, and for “engag[ing] in extensive remedial measures, including enhanced financial controls related to payments and invoicing, enhanced FCPA training, and a new distributor due diligence program.”⁵ Notably, BK Medical did not receive full cooperation credit because, in the view of the DOJ, BK Medical’s “cooperation subsequent to its self-disclosure did not include disclosure of all relevant facts” including “information that was known to [BK Medical] and Analogic about the identities of a number of the state-owned entity end-users of the Company’s products, and about certain statements given by employees in the course of the internal investigation.” The NPA also notes that, by the conclusion of the investigation, BK Medical “had provided to the [DOJ] all relevant facts known to it, including information about individuals involved in the FCPA misconduct.”

While the Pilot Program allows for a discount of up to 50% off the bottom of the U.S. Sentencing Guidelines fine range, BK Medical received only a discount of 30% off the bottom of the range presumably because it did not provide what DOJ considered to be “full” cooperation.

B. JCI Declination and SEC Settlement

According to the settlement documents, from 2004 to 2006, York Refrigeration Marine China Ltd. (“YRMC”), a subsidiary of York International (“York”), made improper payments to agents and others,

⁵ According to the SEC settlement, Analogic’s remedial efforts included: “(1) terminating BK Medical’s relationship with eight distributors; (2) improving BK Medical’s distributor due diligence and distributor agreements; (3) terminating a number of BK Medical employees (including [BK Medical’s CFO] and the Vice President of Sales for distributors) and disciplining other BK Medical employees involved in the transactions; (4) enhancing Analogic’s general oversight of BK Medical and hiring a corporate compliance officer; (5) remediating and improving BK Medical’s internal accounting controls; and (6) requiring additional and ongoing compliance training for BK Medical and Analogic employees.”

including Chinese government personnel at the shipyards, to obtain business. The payments were described in YRMC's books and records as commissions, sales and marketing expenditures, or gifts and entertainment. JCI acquired York in 2005, while York was subject to an ongoing SEC investigation related to FCPA misconduct. Subsequent to JCI's acquisition, the SEC brought an enforcement action against York in 2007, which included charges based on YRMC's conduct. As part of the SEC's resolution with York, JCI had certain obligations, including the appointment of an independent compliance monitor who was required to ensure that JCI properly integrated York into its anticorruption compliance program. JCI devoted additional resources to its compliance program specific to its China-based operations, including hiring a new managing director for its subsidiary, limiting the use of agents, and conducting multiple compliance trainings for its employees.

Despite JCI's remediation efforts, from 2007 to 2015, the new managing director and approximately 18 employees of JCI's China-based subsidiary made payments to sham vendors, some of which were then used to make improper payments of approximately \$4.9 million to employees of Chinese government-owned shipyards, ship-owners and others, to obtain and retain business, as well as to personally enrich employees of the subsidiary. The improper vendor payments were incorporated into JCI's books and records, and the SEC alleged that JCI failed to devise and maintain a system of internal accounting controls that could detect and prevent such payments. JCI learned of the vendor-related conduct in December 2012 when it received the first of two anonymous hotline reports alleging that certain employees at its Chinese subsidiary were making payments to sham vendors.⁶ JCI self-disclosed the potential violations to the SEC and the DOJ and conducted an internal investigation.

On July 11, 2016, it was announced that JCI received a declination letter from the DOJ and entered into a settlement agreement with the SEC with respect to this conduct. In connection with the SEC settlement, JCI will disgorge \$11.8 million in profits and pay \$1.38 million in prejudgment interest and a fine of \$1.18 million for a total payment of approximately \$14.4 million.

As with Analogic and BK Medical, while JCI's self-report occurred before the announcement of the Pilot Program, the DOJ considered the matter under the Pilot Program criteria. The factors considered by the DOJ in declining include: JCI's voluntary self-disclosure; JCI's thorough internal investigation; JCI's full cooperation in the matter (including its provision of all known relevant facts about the individuals involved in or responsible for the misconduct); JCI's efforts to enhance its compliance program and its

⁶ See U.S. SEC. & EXCHANGE COMM'N, *In the Matter of Johnson Controls Inc.*, Exchange Act Release No. 78287 (July 11, 2016), <https://www.sec.gov/litigation/admin/2016/34-78287.pdf> ("SEC Order to JCI").

internal accounting controls; JCI's full remediation,⁷ profit disgorgement and payment of a civil penalty to the SEC; and JCI's agreement to continue to cooperate in any ongoing investigations of individuals.⁸

The DOJ's declination letter warned that the DOJ would reopen the investigation if additional information or evidence so warrants.⁹

C. Analysis

The BK Medical/Analogic and JCI settlements make clear that the DOJ will apply the Pilot Program retroactively to investigations that were pending before the announcement of the Program. Further, the different outcomes for BK Medical and JCI suggest that the DOJ is serious about rewarding full cooperation as they have defined the phrase in the Pilot Program.

While the DOJ always has emphasized the importance of cooperation by companies, the tone appears to have changed somewhat recently. As DOJ Deputy Attorney General Sally Yates remarked to the American Banking Association and American Bar Association Money Laundering Enforcement Conference in November 2015: "[i]n the past, cooperation credit was a sliding scale of sorts and companies could still receive at least some credit for cooperation, even if they failed to fully disclose all facts about individuals. That's changed now. As the policy makes clear now, providing complete information about individuals' involvement in wrongdoing is a threshold hurdle that must be crossed before we'll consider any cooperation credit."¹⁰

The Memorandum announcing the Pilot Program defines "full cooperation" as being "proactive" and "disclos[ing] all relevant facts gathered during a company's independent investigation." Indeed, the

⁷ As detailed in the SEC agreement, JCI's remediation included: terminating or separating from 16 employees implicated in or associated with the illegal scheme and placement of all suspect vendors on a do-not-use/do-not-pay list; the closure of the company's China-based subsidiary's offices and relocation of all remaining employees; enhancement of its integrity testing and internal audits to re-evaluate vendor onboarding of all JCI business worldwide; and implementation of random site audits. *Id.*

⁸ See U.S. DEPT OF JUSTICE, Re: Johnson Controls, Inc., (June 21, 2016), <https://www.justice.gov/criminal-fraud/file/874566/download> ("JCI Declination Letter").

⁹ See *id.*

¹⁰ See Remarks of Deputy Attorney General Sally Quillian Yates before the American Banking Association and American Bar Association Money Laundering Enforcement Conference (Nov. 16, 2015), <https://www.justice.gov/opa/speech/deputy-attorney-general-sally-quillian-yates-delivers-remarks-american-banking-o>. Yates' remarks were precipitated by the DOJ's September 9, 2015 memorandum regarding "Individual Accountability for Corporate Wrongdoing." See Deputy Attorney General Sally Quillian Yates, "Individual Accountability for Corporate Wrongdoing," (Sept. 9, 2015), <https://www.justice.gov/dag/file/769036/download>.

Memorandum notes that “**full cooperation**” is a prerequisite for the DOJ to even consider a declination to prosecute. Here, whereas JCI is credited with providing all known relevant facts about the individuals involved in or responsible for the misconduct, BK Medical and Analogic apparently failed initially to provide information known to them about the identities of a number of the state-owned entity end-users of the Company’s products, and about certain statements given by employees in the course of the internal investigation. Accordingly, not only did BK Medical not receive a declination, but also received only a 30% discount off the bottom end of the U.S. Sentencing Guidelines fine range. Companies considering self-disclosure under the Pilot Program therefore should understand that in order to avail themselves of full credit under the Pilot Program, they cannot pick and choose what information they share with DOJ concerning the findings of their internal investigation.

The BK Medical/Analogic resolution also makes clear, however, that partial—and substantial—credit remains available under the Pilot Program even for a self-reporting company that fails to provide “full cooperation.” Although BK Medical did not provide to DOJ all relevant facts it discovered during its investigation, BK Medical nonetheless received an NPA, and a 30% discount in fines.

Lastly, the BK Medical/Analogic and JCI resolutions underscore the importance to companies of enhancing their compliance programs in parallel to determining what the facts are. The DOJ considers remediation to include a company’s efforts to enhance its compliance program, including through dedicating additional resources and personnel to compliance, ensuring an independent compliance function and auditing of the program to assure effectiveness. Analogic increased its general oversight of BK Medical and hired a corporate compliance officer, addressing two areas of compliance risk underlying its FCPA-related misconduct. JCI enhanced its integrity testing and internal audits to reevaluate vendor onboarding for business worldwide, thereby addressing a weakness in its internal controls concerning vendor relationships. In line with these examples, companies should continually monitor the effectiveness of their compliance programs to ensure that they meet the standards of an effective compliance program set out in the FCPA Resource Guide.¹¹

DOJ’s efforts to provide greater transparency on the implementation of the Pilot Program should be lauded, and we anticipate additional resolutions in the future will provide further insight.

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¹¹ See U.S. DEP’T OF JUSTICE & CRIM. DIV. OF THE SEC. & EXCHANGE COMM’N, *FCPA: A Resource Guide to the U.S. Foreign Corrupt Practices Act* at 57-65 (2012), available at: <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf>.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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