Debevoise & Plimpton

FCPA Update

A Global Anti-Corruption Newsletter

Also in this issue:

5 The EU-U.S. Privacy Shield: Outlook on EU Data Transfers in Internal Investigations

Click here for an index of all *FCPA Update* articles

If there are additional individuals within your organization who would like to receive *FCPA Update*, please email prohlik@debevoise.com, eogrosz@debevoise.com, or pferenz@debevoise.com

The D.C. Circuit's *Lucia* Ruling Bolsters SEC's Use of In-House Courts for FCPA Enforcement

Since the passage of the 2010 Dodd-Frank Wall Street Reform and Protection Act, administrative proceedings have increasingly become the FCPA enforcement method of choice for the Securities and Exchange Commission ("SEC" or "Commission"). On August 9, 2016, the U.S. Court of Appeals for the District of Columbia became the first federal appellate court to directly address the constitutionality of these in-house proceedings. Ruling in favor of the SEC, the Court held that the SEC's use of Administrative Law Judges ("ALJs") does not violate the Appointments Clause of the Constitution.[1]

Continued on page 2

1. *Raymond James Lucia Cos. Inc. v. S.E.C*, No. 15-1345 (D.C. Cir. Aug. 9, 2016).

The D.C. Circuit's *Lucia* Ruling Bolsters SEC's Use of In-House Courts for FCPA Enforcement
Continued from page 1

The SEC's ability to hold hearings before an ALJ, a full-time Commission employee, rather than federal courts, was intended to allow for quicker resolution of Commission enforcement proceedings and to conserve Commission resources. It also brought the SEC under scrutiny, particularly as increasingly complex cases are brought before proceedings that lack the extensive discovery afforded to defendants before federal courts. In July, the SEC adopted amendments to its administrative proceedings rules to afford greater opportunity for defendants to develop their understanding of the facts and arguments. These included additional time for discovery and opportunities for depositions.[2] Concerns remain, however, regarding issues such as the admissibility of hearsay evidence and the lack of flexibility to allow for additional depositions if parties can show good cause.

The *Lucia* Decision

Lucia arose out of alleged violations of the anti-fraud provisions of the Investment Advisers Act. The SEC instituted an administrative enforcement action before an ALJ, who has the authority to conduct a hearing, including the ability to issue subpoenas, examine witnesses and rule upon motions.[3] The ALJ found that Raymond Lucia and his investment firm (collectively, "Lucia") had misled investors regarding the firm's retirement wealth-management strategy. The ALJ's initial decision imposed monetary penalties and a lifetime industry bar on Mr. Lucia.[4] The Commission granted Lucia's request for review and upheld the ALJ's findings in a final Order.

Lucia then appealed the case to the D.C. Circuit, challenging the Commission delegation of authority to ALJs to conduct administrative hearings.[5] Lucia argued that the SEC's administrative hearing was unconstitutional because the ALJ who rendered the decision was an improperly appointed constitutional officer. Specifically, Lucia argued that as constitutional officers, the SEC ALJs should have been appointed pursuant to the Appointments Clause which would require

Continued on page 3

2. Press Release, U.S. Sec. and Exch. Comm'n, SEC Adopts Amendments to Rules of Practice for Administrative Proceedings (July 13, 2016), *available at*: https://www.sec.gov/news/pressrelease/2016-142.html.

3. 17 C.F.R. §§ 200.14, 201.111.

4. *Raymond J. Lucia Cos. Inc.* Initial Decision Release No. 495, 2013 WL 337919 (July 8, 2013).

5. *See* 17 C.F.R. § 200.30-9, delegation of authority to hearing officers pursuant to the provisions of Section 4A of the Securities Exchange Act of 1934.

The D.C. Circuit's *Lucia* Ruling Bolsters SEC's Use of In-House Courts for FCPA Enforcement

Continued from page 2

Presidential appointment, with Advice and Consent of the Senate.[6] Because the ALJs are hired by the SEC, Lucia argued that they were not appropriately appointed and proceedings before them were not valid.

When evaluating whether an appointee is a constitutional "Officer," courts must determine whether the appointee exercises "significant authority."[7] According to the *Lucia* Court, three factors are key to this analysis: (1) the significance of the matters before the official; (2) the discretion they may exercise; and (3) the finality of their decisions.[8] The locus of dispute in *Lucia* was whether the SEC's ALJ issues

"The SEC increasingly has been relying on in-house administrative proceedings for FCPA enforcement actions. . . . [T]he *Lucia* ruling will likely bolster the SEC's confidence with regard to its use of administrative procedures as opposed to actions in court."

the final decisions of the Commission. The D.C. Circuit rejected Lucia's arguments that the ALJ decision was a final determination. Specifically, the Court underscored the Commission's requirement to issue an order, either to review or decline to review each ALJ decision. The Commission's affirmative final step, according to the Court, rendered ALJs employees, not constitutional "Officers" that would require Presidential appointment. In other words, "[t]he Commission's right of discretionary review . . . ensure[s] that the politically accountable Commissioners have determined that an ALJ's initial decision is to be the final action of the Commission."[9]

Continued on page 4

6. U.S. Const. art. II § 2, cl. 2. The Appointments Clause provides that the President, with the Advice and Consent of the Senate, appoints "Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointments of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments."
7. *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).
8. *Lucia*, at 9–10 (citing *Tucker v. Comm'r, Internal Revenue,* 676 F.3d 1129, 1133 (D.C. Circ. 2012)).
9. *Id.* at 13.

Continued from page 3

Implications for FCPA Enforcement

The SEC increasingly has been relying on in-house administrative proceedings for FCPA enforcement actions. Following the passage of the Dodd-Frank Act, there has a notable increasing trend in the percentage of SEC FCPA enforcement actions that involve the SEC's administrative process.[10] For both individual and corporate enforcement actions, 33 percent involved the SEC's administrative process in 2011, 30 percent in 2012, 38 percent in 2013, 75 percent in 2014 and 88 percent last year. In 2016, so far, the SEC has settled twelve out of fourteen enforcement actions through administrative proceedings.[11]

Recourse to the courts remains a possibility in FCPA enforcement, even after a final Commission order. The admissible evidence and scope of review would, however, differ from proceedings that were brought in federal courts in the first instance. Moreover, in practice, the SEC has brought cases involving the most significant penalties in federal courts.[12] That said, the D.C. Circuit is seen as leading court on questions of federal agency powers and its decisions often have influence on the outcome of similar cases. Thus, the *Lucia* ruling will likely bolster the SEC's confidence with regard to its use of administrative procedures as opposed to actions in court.

Colby A. Smith

Jonathan R. Tuttle

Veronica R. Glick

Colby A. Smith and Jonathan R. Tuttle are partners in the Washington, D.C. office. Veronica R. Glick is an associate in the Washington, D.C. office. The authors may be reached at casmith@debevoise.com, jrtuttle@debevoise.com, and vrglick@debevoise.com. Full contact details for each author are available at www.debevoise.com.

Continued on page 5

10. For a full list of SEC administrative proceedings see: https://www.sec.gov/litigation/admin.shtml.

11. *See Key Energy Services Inc.,* SEC Admin. Proc. File No. 3-17379 (Aug. 11, 2016); *Johnson Controls* SEC Admin. Proc. File No. 3-17337 (July 11, 2016); *Analogic Corp. and Lars Frost*, SEC Admin. Proc. File No. 3-17305 (June 21, 2016); *Las Vegas Sands Corp.* SEC Admin. Proc. File No. 3-17204 (Apr. 7, 2016); *Novartis AG*, SEC Admin. Proc. File No. 3-17177 (March 23, 2016); *Nordion Inc* SEC Admin. Proc. File No. 3-17153 (March 3, 2016); *Mikhail Gourevitch* SEC Admin. Proc. File No. 3-17152 (March 4, 2016); *Qualcomm Inc.*, SEC Admin. Proc. File No. 3-17145 (March 1, 2016); *PTC.,* SEC Admin. Proc. File No. 3-17118 (Feb.16, 2016); *SciClone Pharmaceuticals, Inc.,* SEC Admin. Proc. File No. 3-17101 (Feb. 4, 2016); *Ignacio Cueto Plaza,* SEC Admin. Proc. File No. 3-17100 (Feb. 4, 2016); *SAP SE*, SEC Admin. Proc. File No. 3-17080 (Feb. 1, 2016).

12. Notably, however, the largest sanction of the year ($167.5 million) was brought before the U.S. District Court for the Southern District of New York, and part of a global settlement process. *See SEC v. VimpelCom Ltd.,* No. 1:16-cv-1266 (S.D.N.Y. 2016).

The EU-U.S. Privacy Shield: Outlook on EU Data Transfers in Internal Investigations

Although existing European data protection laws are meant principally to restrict the transfer of personal data, they actually do not restrict personal data transfers to public authorities carrying out formal investigations within the EU, the United States, or elsewhere. Rather, these laws restrict the sourcing of personal data in cases of internal corporate investigations, the transfer of information as a result of such investigations, and the voluntary sharing of this information with non-EU prosecuting authorities, *e.g.*, in accordance with common U.S. practice.

The balance of what is permitted and what is not is unaffected by the newly introduced EU-U.S. Privacy Shield, the successor to the Safe Harbor, which was invalidated by the European Court of Justice at the end of 2015 (the *Schrems* decision).[1] However, this may change in May 2018, under the future EU General Data Protection Regulation ("GDPR"). Specifically, this regulation will require that official data transfer requests conform with legal assistance treaties, and it is unclear if this requirement also will affect voluntary submissions to U.S. authorities.

The Current EU Data Protection Concept

The current EU Data Protection Directive and EU member states' data protection laws prohibit data sourcing, processing, and transferring unless there is a legal permission to do so. Out of a series of such permissions, the "legal defense exception" is currently the most important one for internal investigations. It permits, in varying detail among EU member states, the transfer of personal data for the purposes of defending in court or against a government authority's investigation.

As the new Privacy Shield deals with EU-U.S. data transfers between businesses, it has no bearing on investigations by U.S. public authorities and responses involving submissions of requested information. EU law has not changed in this respect.

Continued on page 6

1. *See* "EU Data Transfers to the United States: Practical Consequences of the European Court of Justice's Recent Decision," *FCPA Update* Vol. 7, No. 4 (Nov. 2015), www.debevoise.com/insights/publications/2015/11/fcpa-update-november-2015.

Continued from page 5

Reporting of Findings in Internal Corporate Investigations

However, internal investigations very often involve substantial investigations of facts and circumstances that only in part will be used for legal defense purposes. In some circumstances, the principal aim may be responding to strict compliance requirements under U.S. laws, and a good part of the information arising from an internal investigation may be for internal purposes only. In such cases, the legal defense exception may not be available, and the participants (*e.g.*, U.S. parent, European subsidiary) have to devise other ways of data sourcing and transfers in the context of an investigation.

The sharing of EU personal data with a U.S. recipient that is not an authority can now be made on the basis of the Privacy Shield, if in place. Because the arrangements to be provided by U.S. recipients under the Privacy Shield are cumbersome, data transfers to the United States in ad hoc situations are far more often done on the basis of a Data Transfer Agreement ("DTA") following EU standard clauses.

Increasingly, however, DTAs are coming under scrutiny, following the recent move by the Irish Data Protection Authority to seek a European Court decision on the validity of this type of transfer. Other EU member states' data protection authorities take their own approaches. A common critical issue is whether the DTA provisions in an individual case provide sufficient protections for custodians in light of the Schrems decision of the European Court of Justice. Data transfer arrangements based on DTAs therefore need to be reviewed in the individual circumstances, taking into account the expected exposure of the U.S. data recipient to unwanted accession by third parties, including the U.S. government. Depending on the degree of exposure, additional steps may be necessary to increase the protection of EU data in the particular setting.

Changes To Be Expected Under the EU General Data Protection Regulation

The GDPR, while slightly increasing protective standards, will continue to follow the concept of prohibition and exemption, and the legal parameters for sharing of personal data with U.S. recipients in connection with internal investigations and a voluntary sharing of data with U.S. authorities will principally not change. Article 48 of the GDPR, however, introduces the requirement that official data requests by foreign authorities need to be made in conformity with existing

Continued on page 7

Continued from page 6

Mutual Legal Assistance Treaties. Although there is an exemption for data transfers permitted elsewhere in the GDPR, it remains unclear today how Article 48 may impact voluntary data transfers in response to requests or expectations from U.S. authorities to share information from internal investigations.[2]

Thomas Schürrle

Friedrich Popp

Thomas Schürrle is a partner in the Frankfurt office. Friedrich Popp is an associate in the Frankfurt office. The authors may be reached at tschuerrle@debevoise.com and fpopp@debevoise.com. Full contact details for each author are available at www.debevoise.com.

2. The discussion centers on the relationship between Article 48 of the GDPR, dealing with third country authority data requests, and Article 49 (1) of the GDPR, the legal defense exception. The UK seeks, for example, in a February 4, 2016 statement, to apply the legal defense exception without limitations that may result from Article 48 of the GDPR. *See* http://tinyurl.com/zgecmhw.

FCPA Update

FCPA Update is a publication of
Debevoise & Plimpton LLP

919 Third Avenue
New York, New York 10022
+1 212 909 6000
www.debevoise.com

Washington, D.C.
+1 202 383 8000

London
+44 20 7786 9000

Paris
+33 1 40 73 12 12

Frankfurt
+49 69 2097 5000

Moscow
+7 495 956 3858

Hong Kong
+852 2160 9800

Shanghai
+86 21 5047 1800

Tokyo
+81 3 4570 6680

Paul R. Berger
Co-Editor-in-Chief
+1 202 383 8090
prberger@debevoise.com

Sean Hecker
Co-Editor-in-Chief
+1 212 909 6052
shecker@debevoise.com

Andrew M. Levine
Co-Editor-in-Chief
+1 212 909 6069
amlevine@debevoise.com

Erich O. Grosz
Co-Executive Editor
+1 212 909 6808
eogrosz@debevoise.com

Jane Shvets
Deputy Executive Editor
+44 20 7786 9163
jshvets@debevoise.com

Dr. Friedrich Popp
Assistant Editor
+49 69 2097 5281
fpopp@debevoise.com

Bruce E. Yannett
Co-Editor-in-Chief
+1 212 909 6495
beyannett@debevoise.com

Karolos Seeger
Co-Editor-in-Chief
+44 20 7786 9042
kseeger@debevoise.com

David A. O'Neil
Co-Editor-in-Chief
+1 202 383 8040
daoneil@debevoise.com

Philip Rohlik
Co-Executive Editor
+852 2160 9856
prohlik@debevoise.com

Veronica R. Glick
Assistant Editor
+1 202 383 8153
vrglick@debevoise.com

Please address inquiries regarding topics covered in this publication to the editors.

All content (c) 2016 Debevoise & Plimpton LLP. All rights reserved. The articles appearing in this publication provide summary information only and are not intended as legal advice. Readers should seek specific legal advice before taking any action with respect to the matters discussed herein. Any discussion of U.S. federal tax law contained in these articles was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax law.

Please note:
The URLs in FCPA Update are provided with hyperlinks so as to enable readers to gain easy access to cited materials.