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FCPA Update

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Second Circuit Signals Support for the SEC's Use of "Neither Admit Nor Deny" Language in Consent Settlements

On March 15, 2012, the United States Court of Appeals for the Second Circuit issued an opinion justifying a previously issued stay of district court proceedings in *SEC v. Citigroup Global Markets Inc.*,[1] a case that has drawn much attention following United States District Judge for the Southern District of New York Jed Rakoff's refusal to accept a proposed $285 million settlement that did not require Citigroup to admit wrongdoing. In a per curiam ruling, a motions panel of the Second Circuit found that the Securities and Exchange Commission ("SEC") and Citigroup had made a "strong showing of likelihood of success in setting aside the district court's rejection of their settlement."[2] In making this ruling, the panel indicated skepticism as to the reasoning in Judge Rakoff's opinion, which called into question the longstanding practice used by the SEC of allowing a settling party to neither admit nor deny the allegations made against it. Although these issues will now be the subject of full briefing, the panel's opinion appears to forecast likely Second Circuit support for the SEC's continued use of "neither admit nor deny" language in reaching settlements with defendants. The panel decision also articulated a more limited view of the district court's role in reviewing SEC settlements than it found the court below to have applied.

As the SEC's standard means of resolving cases, settlements utilizing "neither admit nor deny" terms have been used in FCPA resolutions with the SEC. The use of such language allows defendants to deny allegations in shareholder litigation, suits by competitors, and debarment proceedings (as well as criminal matters, should they arise later). Following Judge Rakoff's decision, the SEC adopted new policy standards in FCPA cases where parallel allegations are prosecuted or resolved by the Department of Justice

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1. *SEC v. Citigroup Global Mkts. Inc.*, No. 11-5227, slip op. at 17 (2d Cir. Mar. 15, 2012) [hereinafter "2d Cir. Opinion"]. *See also SEC v. Citigroup Global Mkts. Inc.*, No. 11-5227, Order (2d Cir. Dec. 27, 2011) (granting stay of district court proceedings pending appeal).
2. *Id.*

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("DOJ"). In such cases, when a defendant admits facts in connection with a parallel DOJ proceeding, the SEC will now require admission of the same facts in the resolution with the SEC. The SEC's new policy does not alter the use of "neither admit nor deny" language in resolutions without parallel DOJ proceedings.[3]

Judge Rakoff's Decision

In November 2011, Judge Rakoff rejected a proposed consent judgment between the SEC and Citigroup, raising serious questions about a longstanding practice used in SEC settlements.[4] In order to resolve allegations of fraudulent marketing of collateralized debt obligation instruments, the SEC and Citigroup sought a court-approved $285 million settlement in October 2011. Despite assurances that the court was giving "substantial deference" to the views of the SEC, Judge Rakoff rejected the settlement, holding that it was "neither fair, nor reasonable, nor adequate, nor in the public interest."[5] In particular, the court stated that it doubted that the SEC's policy in consent judgments of permitting corporations to "neither admit nor deny" the charges served any interests other than those of the parties.[6] Rather, the court noted, "a consent judgment that does not involve any admissions and that results in only very modest penalties is just as frequently viewed, particularly in the business community, as a cost of doing business imposed by having to maintain a working relationship with a regulatory agency, rather than as any indication of where the real truth lies."[7]

In response, the SEC appealed to and alternatively sought a writ of mandamus from the Second Circuit to set aside Judge Rakoff's order. Citigroup joined with the SEC in all of its arguments.

The Second Circuit's Analysis

In analyzing whether the parties' request for a stay of the district court proceeding was warranted, the panel was required to evaluate whether the parties had "a strong likelihood of success" in overturning the district court's decision.[8] In so doing, the panel examined – and rejected – each of the three arguments advanced by Judge Rakoff in refusing to approve the settlement.

First, the panel perceived "several problems" with Judge Rakoff's view that a consent judgment without an admission of liability by Citigroup failed to serve the public interest because defrauded investors could not use the judgment in civil suits seeking to recover investors' losses.[9] As the panel observed, "the district court's logic appears to overlook the

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3. For a more in-depth discussion of the SEC's policy changes in light of Judge Rakoff's decision, *see* Paul R. Berger, Bruce E. Yannett, Sean Hecker, David M. Fuhr, and Noelle Duarte Grohmann, "The FCPA in 2011: The Year of the Trial Shapes FCPA Enforcement," *FCPA Update*, Vol. 3, No. 6 at 13-15 (Jan. 2012), http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=20960d4e-4743-40b8-bd29-27e9ed1a16c3.
4. *SEC v. Citigroup Global Mkts. Inc.*, No. 11 Civ. 07387 (JSR), __ F. Supp. 2d __, 2011 WL 5903733 (S.D.N.Y. Nov. 28, 2011).
5. *Id.* at *4.
6. *Id.* at *5.
7. *Id.*
8. 2d Cir. Opinion at 6.
9. *Id.* at 7.

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possibilities (i) that Citigroup might well not consent to settle on a basis that required it to admit liability, (ii) that the SEC might fail to win a judgment at trial and (iii) that Citigroup perhaps did not mislead investors."[10] The panel further noted that Judge Rakoff's argument reflected the "still more significant problem" of failing to defer to an executive-branch agency's "wholly discretionary" policy judgment where the "SEC's decision to settle … was driven by considerations of government policy as to the public interest."[11] Although the district court had "verbally acknowledged" its obligation to defer to the SEC's policy views, the panel found that the district court had effectively "imposed what it considered to be the best policy to enforce the securities laws," leading the panel to conclude that "it is doubtful whether the court gave the obligatory deference to the SEC's views in deciding that the settlement was not in the public interest."[12]

Second, the panel noted its "difficulty reconciling" Judge Rakoff's view that the settlement was unfair to Citigroup – under the theory that the settlement imposed relief on Citigroup based on allegations not established by admissions or by trials – with the district court's earlier observation that the size of the penalties amounted to a "mild and modest cost of doing business."[13] Moreover, the panel expressed its "doubt that a court's discretion extends to refusing to allow a [freely consenting] litigant to reach a voluntary settlement in which it gives up things of value without admitting liability."[14]

Finally, the panel rejected the district court's view that "it could not properly evaluate the fairness of the settlement unless the underlying facts were conclusively established either by a trial or by binding admission of liability."[15] Not only did the panel find that the district court had available to it a "substantial evidentiary record amassed by the SEC," the panel also rejected the underlying premise of the argument, finding "no precedent that supports the proposition that a settlement will not be found to be fair . . . unless liability has been conceded or proved" and expressing "doubt whether it lies within a court's proper discretion to reject a settlement on the basis that liability has not been conclusively determined."[16]

> "[T]he panel expressed its 'doubt that a court's discretion extends to refusing to allow a [freely consenting] litigant to reach a voluntary settlement in which it gives up things of value without admitting liability.'"

The Second Circuit Stay Opinion Should Provide Clarity

In the aftermath of Judge Rakoff's November opinion, other district courts began to express doubts regarding the approval of SEC consent settlements that included the "neither admit nor deny" language, creating uncertainty for those considering a potential settlement with the SEC. Given the possible impact on SEC consent settlements – and the corresponding impact on the number of cases the SEC would be able to bring in federal court – a Second Circuit affirmance of Judge Rakoff's ruling could affect the way both defendants and the SEC approach investigations and settlements. For example, there could be an increase in cases with administrative resolutions (*i.e.*, cease and desist orders) for which court approval is not required. It is also possible that the SEC would opt for more "books and records" cases, in which the elements required to be proven for liability to attach are far less onerous. At the same time, in such cases, the collateral effects are, from certain perspectives, less significant given the absence of a private right of action and the fact that books and records violations are not treated as fraud violations for purposes of debarment under U.S. law (and also do not trigger mandatory

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10. *Id.*
11. *Id.*
12. *Id.* at 9-10.
13. *Id.* at 10.
14. *Id.*
15. *Id.* at 11.
16. *Id.* at 11-12.

Second Circuit Stay Opinion ■ Continued from page 3

debarment issues under E.U. procurement law).

While the motions panel noted that its opinion "does not address the ultimate question to be resolved by the merits panel,"[17] its detailed analysis and outright rejection of many aspects of Judge Rakoff's analysis appear to indicate a likely reversal of the district court order, and support for the SEC's authority to continue to enter into "neither admit nor deny" consent settlements. In addition, the panel's conclusions are likely to serve as a reminder to other courts of the deference that should be granted to settlements reflecting considered policy judgments of the SEC (and other executive agencies). To that end, the panel's decision should also reassure private parties with current or forthcoming settlements with the SEC that the longstanding policy of settling without admitting or denying liability will most likely continue to be the standard practice, and that district courts will be less likely to second-guess the financial and other terms on which such settlements are premised.

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17. *Id.* at 3.

NEWS FROM THE BRICs

Can You Hear Me Now? Lessons from the Indian Supreme Court's 2G Ruling

In response to allegations of fraud and corruption, India's Supreme Court issued an order on February 2, 2012, canceling every 2G mobile phone frequency license that the Indian government has awarded to telecommunication companies since January 2008 – 122 licenses in total.[1] This decision highlights the importance of due diligence and anti-bribery compliance programs when companies conduct business in countries that historically present a greater risk of corruption. India, which is in the midst of a prolonged political battle to enact a new anti-corruption law (the "Lokpal Bill"), has experienced several major corruption scandals involving public officials over the past few years,[2] and ranks 95 out of 183 countries on Transparency International's 2011 Corruption Perceptions Index.[3] As a consequence of the Indian Supreme Court's ruling, foreign (*i.e.,* non-Indian) companies that formed joint ventures with, or invested in, Indian companies that held licenses, have suddenly found their investments substantially devalued, if not worthless.

The Centre for Public Interest Litigation and other Indian advocacy groups and individuals petitioned the Indian Supreme Court to cancel the licenses after India's Telecommunications Minister, Andimuthu

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1. *See* James Lamont, James Fontanella-Khan, James Crabtree, and Daniel Thomas, "Indian Court Revokes 122 Mobile Licenses," *Financial Times* (Feb. 2, 2012), http://www.ft.com/intl/cms/s/0/460354c8-4d6e-11e1-bb6c-00144feabdc0.html#axzz1ouq5jRVy.

2. *See* Paul R. Berger, Steven S. Michaels, and Aaron M. Tidman, "News from the BRICs: Developments in Indian Anti-Corruption Legislation," *FCPA Update*, Vol. 2, No. 9 (Apr. 2011), http://www.debevoise.com/files/Publication/1c64487e-a691-4059-a8fc-c0b62aecad8f/Presentation/PublicationAttachment/be5fcf08-bb71-4626-a866-e7f178be0c8a/FCPAUpdateApril2011.pdf.

3. *See* Transparency International, Corruption Perceptions Index (2011), http://cpi.transparency.org/cpi2011/results.

Lessons from the India 2G Ruling ■ Continued from page 4

Raja, and several other government officials and telecommunications company executives were arrested in early 2011 for allegedly selling the cell phone frequency licenses at a reduced price in 2008.[4] The advocacy groups argued that the system Minister Raja used to award licenses – a first-come, first-served basis – was unconstitutionally opaque and arbitrary.[5] They argued that the system allowed government officials such as Minister Raja to notify their friends before the public and receive kickbacks.

In order to soften the blow, the Indian Supreme Court's ruling does not take effect for four months, at which point the government must publicly auction the licenses in an equitable and transparent manner. According to the ruling, a transparent auction would result in more money for the government[6] and help to prevent fraud by "unscrupulous people who are only interested in garnering maximum financial benefit and have no respect for the constitutional ethos and values."[7] All licenses granted before 2008 will remain intact because they were not part of the lawsuit.

The Indian Supreme Court's ruling potentially reaches far beyond the telecommunications industry. In its explanation of why an auction method is constitutionally fair and transparent, the Indian Supreme Court couched its language in general terms, writing:

> When it comes to alienation of scarce natural resources like spectrum, etc., it is the burden of the State to ensure that a non-discriminatory method is adopted for distribution and alienation, which would necessarily result in protection of national/public interest. In our view, a duly publicized auction conducted fairly and impartially is perhaps the best method for discharging this burden and the methods like first-come-first-served . . . are likely to be misused.[8]

Other licenses that the Indian government has distributed for "scarce natural resources" on a first-come, first-served (or other non-auction) basis, such as mining,[9] liquor, and real estate licenses, might now also be unconstitutional and void.[10] The 2G ruling potentially could lead to years of litigation in other industries over the years to come.

Takeaways

The 2G ruling has created some regulatory uncertainty that may discourage potential foreign investments in India. The fact remains that India attracted $50 billion in foreign direct investment ("FDI") in the first 11 months of 2011 – up 13 percent from a year earlier.[11] With a projected GDP growth rate of 7% for 2012,[12] and the Indian government's plans to double spending on infrastructure in the coming years, the Indian economy is poised to attract significantly more foreign capital regardless of any fallout from the 2G ruling. Dealmakers should understand the compliance risks of doing business in India, and all companies should conduct thorough due diligence before making investments.

A robust due diligence and compliance program should be able to identify and escalate to senior management evidence of "red flags" such as atypical payment patterns, lack of transparency in accounting records, unusually high commissions, a history of corruption in the particular industry,[13] and an apparent lack of qualifications or resources to perform the services offered. In light of the 2G

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4. *See* Shefali Anand, "India's 2G Ruling Shocks Telecom Industry," *The Wall Street Journal* (Feb. 2, 2012), http://blogs.wsj.com/indiarealtime/2012/02/02/indias-2g-ruling-shocks-telecom-industry/; *see also* Lamont *et al.*, note 1, *supra*.
5. *Ctr. for Pub. Interest Litig. v. Union of India*, (2012) Writ Petition (Civil) No. 423 of 2010 (India) (on file with author) [hereinafter "2G Ruling"].
6. The court wrote: "We have no doubt that if the auction method had been adopted . . . the nation would have been enriched by many thousand crores." *Id.* at ¶ 76. This argument is also supported by the Central Bureau of Investigation's allegation that Minister Raja's fraud cost the Indian government nearly $40 billion in lost revenue. *See* "India's Corruption Scandals," *BBC News South Asia* (Mar. 17, 2011), http://www.bbc.co.uk/news/world-south-asia-12769214?.
7. 2G Ruling ¶ 76.
8. *Id.*
9. In fact, in February of this year, it was reported that an Indian state minister, B.S. Yeddyurappa, received kickbacks from mining companies in return for grants of mining leases. *See* "Yeddyurappa Family Got Kickbacks From Miners," *Business Standard* (Feb. 22, 2012), http://www.business-standard.com/India/.
10. *See* Rupa Subramanya, "Economics Journal: Why the 2G Verdict Is a Win," *The Wall Street Journal* (Feb. 6, 2012), http://blogs.wsj.com/indiarealtime/2012/02/06/economics-journal-why-the-2g-verdict-is-a-win/.
11. Henry Foy, "India still a foreign investment hot spot-E&Y," *Reuters* (Jan. 29, 2012), http://www.reuters.com/article/2012/01/29/india-investment-idUSL4E8CR3D920120129.
12. "IMF lowers India's growth forecast to 7%," *The Indian Express* (Jan. 24, 2012), http://www.indianexpress.com/news/imf-lowers-indias-growth-forecast-to-7/903568/.
13. Industries such as construction, telecommunications, and power have a particularly high risk of corruption, particularly compared to industries such as business process outsourcing. *See* Kerry Francis, Walt Brown, and Hema Hattangady, "India and the Foreign Corrupt Practices Act," *Deloitte Forensic Center*, http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_dfc_indiaandfcpa_05192011.pdf.

Lessons from the India 2G Ruling ■ Continued from page 5

ruling, due diligence in India should also now include a close examination of any government licensing procedures, as well as a careful backward-looking review of how the Indian entity received any licenses in the past, particularly if the entity's value is highly contingent on the validity of such licenses.

> "Because private companies are under no obligation under Indian law to install corporate governance mechanisms, it is that much more important to evaluate their internal compliance and control procedures more thoroughly."

Many questions have also been raised as to the standards of corporate governance in Indian businesses that are mostly promoter led and family controlled. Newly listed companies in India and public companies above a certain prescribed size[14] have to comply with Clause 49 of the listing agreement of the stock exchanges, which imposes certain U.S.-style independent director[15] and audit committee requirements.[16] However, the reality is that independent directors in Indian companies do not play the type of proactive role that is common in Europe and the United States and very rarely vote against the promoters. Because private companies are under no obligation under Indian law to install corporate governance mechanisms, it is that much more important to evaluate their internal compliance and control procedures more thoroughly. Additionally, many businesses in India are still structured as family-owned group businesses with great interdependence on one another, and consequently, there can be extensive related party transactions which must also be identified and examined.

Despite concerns about regulatory uncertainty after the 2G ruling and potential corruption in certain industries, foreign companies are investing in India at an ever-increasing rate. Thorough due diligence and robust compliance programs are the best way to ensure these investments' success.

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14. Companies with a paid up share capital of more than 30 million Rupees or a net worth of over 50 million Rupees at any time in the history of the company have to comply with Clause 49 of the listing agreement. Letter from Parag Basu, Deputy General Manager of the Securities and Exchange Board of India to Directors or Administrators of all the Stock Exchanges regarding Corporate Governance in Listed Companies – Clause 49 of the Listing Agreement (Oct. 29, 2004), http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf (attaching Clause 49 of the listing agreement).

15. *See id*. Clause 49 I(A) of the listing agreement states that:
    (i) The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.
    (ii) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

16. *Id*. Clause 49 II(A) of the listing agreement states that:
    A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:
    (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
    (ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

SFO Successfully Prosecutes Four Individuals for Private Sector Corruption in Offshore Oil and Gas Projects

The U.K. Serious Fraud Office ("SFO") has recently obtained custodial sentences against four individuals who conspired to obtain corrupt payments in exchange for confidential information relating to five oil and gas engineering and procurement projects worth £66 million in Iran, Egypt, Russia, Singapore and Abu Dhabi between 2001 and 2009.

This case demonstrates the SFO's willingness to prosecute commercial bribery in offshore projects, and the continued focus of regulators on the oil and gas industry. In addition, it highlights a recurring feature in global corruption: the willingness of bidders to make corrupt payments for confidential information that could give them an advantage over their competitors. Finally, it reinforces a lesson to companies in all fields: the highest risk of corruption and impropriety often resides in temporary workers who are not fully vetted.

The prosecutions were the culmination of Operation Navigator, a joint investigation by the SFO and the City of London Police that commenced in April 2008.

Two of the four defendants (plus one Philippines-based individual whom the SFO has not been able to bring to trial in the United Kingdom) hired themselves out as agency workers and contractors to various U.K. companies specializing in providing procurement services for large oil and gas projects. That allowed them access to confidential procurement information, which they then passed on to the other defendants, who offered the information to bidding companies in return for cash.

At least six bidders (based in various places, including Italy, Egypt, Canada and France) made or agreed to make payments in return for the information.[1] These payments were disguised as "consultancy services" by the bidders. But GE Water & Process Technologies, a subsidiary of General Electric Company, rejected an approach from one of the defendants and reported the approach to the procurement company, which then informed the authorities.

The defendants each received custodial sentences ranging from 12 months (suspended for 18 months) to five years.[2] Two of the defendants were also disqualified from acting as company directors for a period of 10 years. In addition, the SFO intends to bring confiscation proceedings against three of the defendants.

The SFO stated that the procurement companies "were appalled at the apparent blatant disregard shown by these defendants for the confidentiality and integrity of the project environments."[3]

Richard Alderman, Director of the SFO, added: "Demanding backhanders in exchange for confidential and advantageous information saps business and is completely unacceptable to society. Hopefully these sentences will ring out the message loud and clear that the criminal justice system will do all it can to combat wrong-doing like this."[4]

Because the offences were committed prior to July 1, 2011, the date of entry into force of the U.K. Bribery Act 2010 ("Bribery Act"), the prosecutions were brought under the United Kingdom's earlier legislative regime, which is made up of a patchwork of common law and statutory law offences. The SFO's approach to enforcement of pre-Bribery Act violations was discussed in a previous *FCPA Update*.[5]

It does not appear that the SFO has proceeded against either the U.K.-based procurement companies who employed the individuals, or the non-U.K. bidders who made or agreed to make the corrupt payments.

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1. SFO Press Rel., Four Guilty in £70 Million Contracts Corruption Case (Jan. 25, 2012), http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2012/four-guilty-in-70-million-contracts-corruption-case.aspx.
2. SFO Press Rel., Prison Terms for Corruption in Oil and Gas Contracts (Jan. 31, 2012), http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2012/prison-terms-for-corruption-in-oil-and-gas-contracts-.aspx
3. *See* note 1, *supra*.
4. *See* note 2, *supra*.
5. Karolos Seeger, Philip Rohlik, Sarah J. Thomas, and Matthew H. Getz, "Trends in Recent SFO Enforcement Activity, *FCPA Update*, Vol. 3, No. 4 (Nov. 2011), http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=0f4c1703-b083-4622-ac28-27f36e5f10dc.

SFO Prosecutions ■ Continued from page 7

Had the offenses been committed on or after July 1, 2011, it is quite possible that the SFO may have sought to prosecute the bidders as well. The SFO has not stated why it has not prosecuted the bidders for paying or agreeing to bribes, but it is plausible that there is no jurisdiction over them under previous laws, which generally affected only U.K. companies (or actions that took place in the United Kingdom). Under the Bribery Act, however, since the bidders' employees or agents paid or offered to pay for the confidential information, they could well have been prosecuted for the corporate offense of failing to prevent bribery if they merely carried on a business or part of a business within the United Kingdom.[6] (A company's only defense to that offense is a demonstration that it had adequate procedures in place to prevent bribery.)

These convictions illustrate the need for companies to engage in periodic risk assessment, and to be as watchful over commercial bribery as they are over bribery of public officials.

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6. Given the facts of this case, it is less likely that the SFO could have proceeded against the procurement companies even under the terms of the Bribery Act, as there is no corporate offence of failing to prevent the receipt – as opposed to the paying – of bribes by associated persons.

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March 28, 2012
Michael B. Mukasey
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June 7th, 2012
Philip Rohlik
Asia Discovery Exchange 2012
Proactive Legal Management - Dialogue - Transforming reactive to proactive eDiscovery benefits business and litigation outcomes.
Website: http://www.asiaediscovery.com/

June 26-27, 2012
Bruce E. Yannett
"What the Latest Cases Reveal About the US DOJ and SEC Enforcement Priorities"
Karolos Seeger
"Optimising Compliance: How Leading Companies are Enhancing their Compliance Programmes One Year After the Implementation of the UK Bribery Act"
6th Annual European Forum on Anti-Corruption
C5
London
Conference information: http://www.c5-online.com/2012/683/anti-corruption-london/overview