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FCPA Update

A Global Anti-Corruption Newsletter

Also in this issue:

9 Risks and Opportunities Arising from DOJ's New "Compliance Counsel"

14 D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents

21 How Companies Can "Self-Clean" Corruption, Thanks to EU Reforms

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

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The SEC Announces First FCPA Enforcement Action Based on Allegedly Improper Hiring of Relatives of Foreign Officials

Since August 2013, news organizations have widely reported that the U.S. Securities and Exchange Commission ("SEC") and the U.S. Department of Justice ("DOJ") have been investigating a number of U.S.-based financial institutions for potentially hiring the relatives of foreign officials for prestigious jobs and internships in connection with efforts to win or retain business controlled by those officials.

The announcements set off a heated debate in the legal community about whether such allegations could form the basis for enforcement actions under the FCPA and, in particular, whether providing a job to an official's relative (rather than to the official personally) could constitute providing a "thing of value" to the official.

Continued on page 2

The SEC Announces First FCPA Enforcement Action Based on Allegedly Improper Hiring of Relatives of Foreign Officials
Continued from page 1

Commentators also raised questions about whether the government's enforcement focus in this area was at odds with common practices in the commercial sector, in which client representatives (in the United States and elsewhere) frequently request or recommend that a relative or close associate be hired for an internship or entry-level position.

On August 18, 2015, the SEC offered its first public response to these questions, announcing a settlement, effected through an administrative Cease-and-Desist Order, with the Bank of New York Corporation ("BNYM"). This Order included allegations, which BNYM neither admitted nor denied, related to the bank's hiring of three interns who were related to officials employed by a Middle Eastern sovereign wealth fund that placed assets for management with the bank.[1] The SEC took the opportunity to put forward an expansive interpretation of how the FCPA applies in this context. Although untested by judicial review, the BNYM Order plants the SEC's flag on a number of key issues arising under the FCPA and provides important information about the agency's theory for enforcement relating to the recurring issues posed by requests by officials to assist relatives who are seeking employment with FCPA-covered companies.

The BNYM Order

The BNYM Order concerned certain subsidiaries of BNYM's global investment management division (the "BNYM subsidiaries") that had longstanding business relationships with an unidentified sovereign wealth fund for a Middle Eastern country (the "Sovereign Wealth Fund").[2] The Order alleges that, in approximately February 2010, two officials employed by the Sovereign Wealth Fund, and who had discretion over whether to maintain or place new assets for management with the BNYM subsidiaries, separately requested that BNYM hire three individuals for internships at the bank, and that the bank ultimately granted the requests.[3] As the Order explains, "delivering the internships as requested was seen by certain relevant BNY Mellon employees as a way to influence the officials' decisions."[4]

The first official, identified as Official X, requested internships for both his son and his nephew, allegedly calling the requests an "opportunity" for the BNYM subsidiaries and suggesting that, alternatively, he could "secure internships for his

Continued on page 3

1. SEC Exchange Act Release No. 75720, In the Matter of the Bank of New York Mellon Corporation (Aug. 18, 2015) (the "BNYM Order" or the "Order").
2. BNYM Order ¶¶ 10-13.
3. Id. ¶¶ 14-18.
4. *Id.* ¶ 14.

The SEC Announces First FCPA Enforcement Action Based on Allegedly Improper Hiring of Relatives of Foreign Officials

Continued from page 2

family members from a competitor of BNY Mellon."[5] BNYM's relationship managers sought to accommodate the official's requests, despite their "personal" nature, allegedly believing that "by not allowing the internships to take place, we potentially jeopardize our mandate" with the Sovereign Wealth Fund.[6] One employee allegedly expressed a desire to obtain "more money for this," given that the bank was "doing [Official X] a favor."[7]

"Although the bank had 'a specific FCPA policy' in place during the relevant period, the SEC faulted BNYM for not providing employees with training and 'guidance that was tailored to the types of risks relating to hiring faced by BNY Mellon's international asset services unit,' noting that BNYM had 'few specific controls relating to the hiring of customers and relatives of customers, including foreign government officials.'"

At about the same time, the second official, identified as Official Y, requested an internship for his son with BNYM. The relevant BNYM relationship manager allegedly explained to more senior officers at BNYM that granting the request was likely to "influence any future decisions taken within the [Sovereign Wealth Fund]," and that if BNYM did not hire the official's son as an intern, one of its competitors would, potentially resulting in BNYM's loss of market share.[8] The relationship manager allegedly expressed a belief that it is "silly things like this that help influence who ends up with more assets / retaining dominant position," and that granting the official's request was the "only way" to increase BNYM's market share with the Sovereign Wealth Fund.[9]

The bank ultimately hired all three interns, allegedly with the "support" and "blessing" of "senior BNY Mellon employees."[10] Two of the internships were in Boston, and the third was in London.[11] One was unpaid.[12] The Order alleges that the internships were "bespoke," in that the candidates did not have the necessary

Continued on page 4

5. *Id.* ¶ 15.
6. *Id.* ¶ 16.
7. *Id.* ¶ 16 (alteration in original).
8. *Id.* ¶ 18.
9. *Id.*
10. *Id.* ¶ 23.
11. *Id.* ¶ 21.
12. *Id.* ¶ 22.

The SEC Announces First FCPA Enforcement Action Based on Allegedly Improper Hiring of Relatives of Foreign Officials

Continued from page 3

qualifications to be hired through BNYM's ordinary internship hiring process; the internships (of approximately six months) lasted longer than BNYM's standard summer internships; and the internships were not expected to lead to full-time employment.[13] The Order alleges that the interns proved to be "less than exemplary employees."[14] The Sovereign Wealth Fund remained a client of the BNYM subsidiaries, placing a relatively small amount of additional funds with the bank in June 2010 ($689,000 out of a total of approximately $55 billion placed with BNYM by the Sovereign Wealth Fund over the life of the relationship), shortly before the internships began.[15]

Based on these allegations, the SEC charged BNYM with violating the FCPA's anti-bribery provisions "by corruptly providing valuable internships to relatives of foreign officials from the Middle Eastern Sovereign Wealth Fund in order to assist BNY Mellon in retaining and obtaining business," as well as with failing to "maintain a system of internal accounting controls sufficient to provide reasonable assurances that its employees were not bribing foreign officials."[16] Although the bank had "a specific FCPA policy" in place during the relevant period, the SEC faulted BNYM for not providing employees with training and "guidance that was tailored to the types of risks relating to hiring faced by BNY Mellon's international asset services unit," noting that BNYM had "few specific controls relating to the hiring of customers and relatives of customers, including foreign government officials."[17]

Notably, however, the SEC commended BNYM for "enhancing its anti-corruption compliance program," even before SEC's investigation began, and identified a set of remedial steps adopted by the bank (discussed below) that can form the basis of an effective program in this context. Without admitting or denying the alleged facts, BNYM agreed to pay disgorgement of $8.3 million, prejudgment interest of $1.5 million, and a penalty of $5 million.

Key Legal and Compliance Issues

The BNYM Order raises a number of significant issues about how the SEC interprets the FCPA and how companies should be managing compliance going forward. It also identifies other issues to watch as similar investigations move toward resolutions.

Continued on page 5

13. *Id.* ¶¶ 19-22.
14. *Id.* ¶ 24.
15. *Id.* ¶¶ 11-13.
16. *Id.* ¶¶ 31.
17. *Id.* ¶¶ 25, 27.

Continued from page 4

A. In the SEC's View, a Thing of Value Can Be Purely Psychological

As noted above, the government's investigations in this area face a key threshold legal issue under the FCPA: can providing a job or internship to an official's relative constitute a thing of value to the official him/herself? Can offering the purely psychological benefit of helping a child or relative land a job give rise to an actionable attempt at bribery? The official does not stand to see any personal financial gain from the internship, except in the arguable circumstance of reducing the official's financial obligations to a dependent. But the SEC seems to have purposely disclaimed – or at least strained – that theory here, given that one of the internships at issue was unpaid. The SEC addressed this thorny issue in a single sentence in the Order, asserting that "[t]he internships were valuable work experience, and the requesting officials derived significant personal value in being able to confer this benefit on their family members."[18]

The SEC has previously suggested that an intangible benefit can be a "thing of value" under the FCPA, having faulted Schering-Plough for providing a requested donation to a legitimate charity with which a foreign official and his spouse were closely involved, in an alleged attempt to influence the official.[19] The BNYM Order, however, seems to represent a significant expansion of that thinking. Notably, in *Schering-Plough* the SEC charged only a "books and records" violation, not a violation of the FCPA's anti-bribery provisions.[20] Moreover, even assuming intangible prestige or listing an internship on a resumé can be a thing of value, *Schering-Plough* at least involved a transfer of funds at the official's request, which arguably allowed the official *himself* to reap the prestige of the donation. Here, the prestigious and valuable work experiences – one of which was entirely *unpaid* – went not to the official but to the official's family member, and thus only indirectly benefited the official.

B. Evidentiary Issues: Quid Pro Quo or Internal Speculation?

The BNYM case and others like it also raise difficult evidentiary issues for FCPA enforcement authorities. How can one draw the line between a genuine *quid pro quo* – an actual exchange of a personal benefit to an official for a business assignment – from mere internal speculation and anxiety about potentially damaging an important relationship? Here, the BNYM Order is notable for what it *does not* say: the Order does not place the internship hiring requests in the context

Continued on page 6

18. *Id.* ¶ 21.

19. SEC Exchange Act Release No. 49838, In the Matter of Schering-Plough Corporation (Jun. 9, 2004), https://www.sec.gov/litigation/admin/34-49838.htm.

20. *Id.* (Part V).

Continued from page 5

of any specific business opportunity, or any review or re-evaluation of whether the Sovereign Wealth Fund should maintain its existing business relationship with BNYM. Rather, the cited internal communications reflect a generalized desire to gather additional business in the future or to a perception that existing business could be diminished relative to competitors.

Here, the lack of any tie to a concrete business opportunity could simply be a function of the asset management business, in which funds for investment are (in general terms) fungible. Time will tell whether, in other contexts, courts or enforcement authorities will focus more on an attempt to win a specific business opportunity rather than simply an effort to create or maintain good relations that may (or may not) bear fruit over time. For now, the SEC appears to have followed the controversial "*quid pro quo* lite" theory that has garnered some success in DOJ criminal domestic bribery prosecutions; in that sense, the reach of the Order may not be that surprising – although its theoretical underpinnings in the FCPA arena remain largely untested.[21]

The SEC's justification for the imposition of a disgorgement remedy is also difficult to locate within its factual recitation. The disgorgement amount of $8.3 million cannot be explained by the relatively minor new investment with BNYM (of less than $1 million). It stands to reason, then, that the disgorgement amount is based, at least in part, on BNYM's retention of its existing business with the Sovereign Wealth Fund. The causation analysis on that point is not transparent, as the facts stated do not suggest any meaningful way to assess the degree to which the intern hires arguably contributed to maintaining the existing relationship. The result may be the product of any number of unstated factors that went into the settlement, highlighting once again, why settlements should not make law.

C. For Those Companies Exposed to Similar Risk, the SEC Views Training Specifically Focused on Hiring Officials or Their Relatives as a Required Internal Control

The BNYM Order is notable in another respect: although, prior to the announcement of these investigations in 2013, the government had never openly pursued FCPA enforcement actions of this kind, the SEC nonetheless faulted the bank for not having internal controls and training programs targeted to the specific FCPA risks of hiring the relatives of foreign officials. Going forward, that finding in the BNYM Order likely will be viewed as putting other FCPA-covered companies that are exposed to similar risks on notice that the SEC views such

Continued on page 7

21. *See* B. Yannett, S. Hecker, S. Michaels, and N. Grohmann, "Corrupt Intent, Relationship-Building, and *Quid Pro Quo* Bribery: Recent Domestic Bribery Cases," *FCPA Update,* Vol. 3, No. 2 (Sept. 2011), http://www.debevoise.com/insights/publications/2011/09/fcpa-update.

Continued from page 6

targeted training efforts and controls as a required element of an adequate system of internal controls.

D. The SEC's Recommended Internal Controls

The SEC outlined the components of a program – instituted by BNYM prior to the SEC's investigation – that will likely be deemed to constitute an adequate system of controls in this context. Taking the Order as guidance, FCPA-covered companies should consider the following in designing controls to mitigate the risks posed by internship and other hiring programs:

- Anti-corruption policies and training programs should explicitly address the hiring of government officials' relatives;
- Require that every application for employment (full time or internship) be routed through a centralized HR application process;
- Require employees to certify (on an annual or other periodic basis) that they have not circumvented or made hires outside of that centralized process;
- Require as part of the centralized process that candidates for employment indicate whether they are related or closely associated with a current or recent government official; and
- For those cases involving a connection to a foreign official, require additional review by the company's anti-corruption group.[22]

"[C]ompanies should make sure any connected internship or employment candidate is objectively qualified for the position he/she is seeking, that the position reflects a genuine open requirement for the company (rather than a manufactured position), and that the hiring of the candidate could not be perceived in any manner as being connected to winning or retaining a particular business opportunity."

In addition to these measures, and the targeted training referenced above, companies should make sure any connected internship or employment candidate is objectively qualified for the position he/she is seeking, that the position reflects a genuine open requirement for the company (rather than a manufactured position), and that the hiring of the candidate could not be perceived in any manner as being connected to winning or retaining a particular business opportunity.

Continued on page 8

22. BNYM Order ¶ 32.

Continued from page 7

E. Issues to Watch

Overall, the BNYM Order highlights two areas of frequent criticism of FCPA enforcement. First, the activity under scrutiny bears a strong similarity to what are perceived as common practices in the private sector in which firms seek to accommodate client representative requests in order to maintain good relations with key decision makers. In this way, enforcement authorities risk criticism that they are using the FCPA to excise business practices affecting relationships with foreign officials abroad that are routinely tolerated in the private sector in the United States – and that are not unprecedented or even rare in the context of companies' relationships with officials employed by the United States federal, state, and local governments.

Second, the SEC's choice of a consented-to cease-and-desist order to announce a new and expansive interpretation of the FCPA leaves its interpretations of the law entirely untested by judicial scrutiny and adversarial process. Given that BNYM did not admit the allegations in the Order, BNYM had very little incentive to challenge the SEC's view of the facts and law, yet as with Schering-Plough's resolution (referenced above), the SEC's debatable interpretive position may go years (or decades) without judicial scrutiny.

As noted at the outset, the BNYM Order is just the first resolution of a case of this kind. Others may follow, including in DOJ matters, which will likely shed additional light on the landscape in this area.

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Continued on page 9

Risks and Opportunities Arising from DOJ's New "Compliance Counsel"

Late last month, Andrew Weissmann, the Chief of the Fraud Section of the U.S. Department of Justice ("DOJ") announced that the DOJ would be hiring a "compliance counsel." This individual reportedly will serve as an in-house expert "to help prosecutors 'differentiate the companies that get it and are trying to implement a good compliance program from the people who have a near-paper program.'"[1] According to press reports of Weissmann's statements, the compliance expert, who has been selected and is undergoing final vetting, hails from the private sector, has significant experience in developing and implementing compliance programs, and will be a resource to prosecutors in FCPA and non-FCPA cases alike.[2]

The DOJ, of course, already has provided guidance about what it expects from compliance programs in its 2012 *Resource Guide to the U.S. Foreign Corrupt Practices Act*, published jointly with the U.S. Securities and Exchange Commission.[3] DOJ has also issued internal guidance from which prosecutors are to work when assessing company compliance programs in the course of determining when to charge a company with an FCPA or other criminal law violation.[4] And the U.S. Sentencing Commission has issued guidelines, which the Supreme Court has held are "advisory" for the U.S. federal courts,[5] governing what sentence is appropriate in light of such matters as the effectiveness of a company's compliance program.[6] The Sentencing Guidelines apply upon conviction of an offense, but they are also routinely utilized to identify appropriate penalties in the course of settlement discussions, and are customarily analyzed in Deferred Prosecution Agreements ("DPAs") presented by the parties to corporate resolutions to the U.S. courts.

Continued on page 10

1. Joel Schectman, "Compliance Counsel to Help DOJ Decide Whom to Prosecute," *The Wall Street Journal* (July 30, 2015), http://blogs.wsj.com/riskandcompliance/2015/07/30/compliance-counsel-to-help-doj-decide-whom-to-prosecute/. *See also* Karen Freifeld, "U.S. Justice Department Hiring Compliance Expert," *Reuters* (July 30, 2015), http://www.reuters.com/article/2015/07/30/doj-compliance-hire-idUSL1N10A26420150730.
2. *See* sources cited at note 1, *supra*.
3. *See* U.S. Dep't of Justice & U.S. Sec. and Exch. Comm'n, "A Resource Guide to the U.S. Foreign Corrupt Practices Act" (Nov. 14, 2012), http://www.justice.gov/criminal-fraud/fcpa-guidance.
4. *See* U.S. Attorney's Manual, *Principles of Federal Prosecution of Business Organizations* §§ 9-28.000 to 9-28.1300 (2008), http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.
5. *See United States v. Booker*, 543 U.S. 220 (2005).
6. *See* U.S. Sentencing Commission, 2014 Federal Sentencing Guidelines Manual Chapter 8 (effective Nov. 1, 2014), http://www.ussc.gov/guidelines-manual/2014/2014-chapter-8.

Continued from page 9

In light of existing guidance, the main benefits from this new appointment – if and when it is finalized – seems most likely to be greater standardization of DOJ's expectations for compliance programs and hopefully a further indication of DOJ's seriousness in considering such programs when making charging decisions, even absent a formal compliance defense. While such standardization ideally should promote greater fairness in administration of the criminal law, the impact of the DOJ's new hire remains uncertain. Companies, their boards, compliance officers, and in-house legal staff will thus doubtless be awaiting details on how this individual will function.

In this article, we identify some of the risks, opportunities, and issues presented by this innovative step by DOJ.

Practical Issues Presented by a DOJ Compliance Expert

To appreciate the issues that might arise under the DOJ compliance expert's tenure, it is important for companies and their employees to be aware of some of the baseline rules governing criminal prosecutions. Because the FCPA has no compliance defense, compliance programs and their features come into play in an FCPA criminal matter principally at the stage at which DOJ considers whether to bring charges and then, if a conviction or settlement results, what the terms of sentence or penalty should be.

Although consistency in criminal law enforcement is an enormously important goal, the DOJ's exercise of its prosecutorial discretion to select which cases not to bring is largely unreviewable. As the Supreme Court held 30 years ago, in *Heckler v. Chaney*, "[t]his Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion."[7] For this reason, among others, absent a case in which a prosecution has been initiated, say, in retaliation for that defendant's exercise of a constitutional right, or on the basis of a defendant's or another's race, religion, gender, or other protected class, the ability of a defendant to obtain dismissal of a charge on the basis of a claim of selective prosecution is limited.[8] There is thus little likelihood that any corporate defendant could successfully argue that it received an unlawful result if it were prosecuted after having a compliance program in all material respects identical to that of a company that received a declination. Under existing law and procedure, many other facts can go into a particular charging decision.

Continued on page 11

7. 470 U.S. 821, 831 (1985).
8. *See, e.g., United States v. Blankenship*, No. 5:14-cr-00244, 2015 WL 1565710 (S.D.W.Va. Apr. 8, 2015).

Risks and Opportunities Arising from DOJ's New "Compliance Counsel"
Continued from page 10

Even to the extent a goal of DOJ's hiring a compliance counsel is to bring greater consistency to evaluations of corporate compliance programs, this development probably will not provide companies with formal routes of redress if any particular level of consistency is not ultimately achieved. It would require a significant change in DOJ policy to give the "compliance program factor" that is to be assessed along with eight others pursuant to the DOJ's *Principles for the Federal Prosecution of Business Organizations* ("*Principles*") a general outcome-determinative effect. And, as there is no suggestion yet that DOJ's proposed compliance expert will have any formal or practical veto over charging decisions, a key role of the DOJ's new compliance expert is likely to focus on serving as a clearinghouse for expertise about what can reasonably be expected from a corporate compliance program. There is also no suggestion so far that, even in the process by which compliance programs are given weight now in the charging decision, DOJ will be retreating from the current policy that the "critical factors" for assessment of a compliance program involve whether the program is "adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives."[9]

"[T]he appointment of a compliance expert holds out some hope that DOJ will be better able to signal to companies how they should devote compliance resources to meet the 'adequately designed for maximum effectiveness' standard. The appointment may even signal the possibility that DOJ could reformulate the standard for compliance programs in a way that better accords with basic principles of internal control."

While no changes to the *Principles* have been announced, the appointment of a compliance expert holds out some hope that DOJ will be better able to signal to companies how they should devote compliance resources to meet the "adequately designed for maximum effectiveness" standard. The appointment may even signal the possibility that DOJ could reformulate the standard for compliance programs in a way that better accords with basic principles of internal control. As Fraud Section Chief Weissmann stated to the press, one task for the compliance expert will involve "'benchmarking with various companies in a variety of different industries

Continued on page 12

9. *Principles* at § 9-28.800(B).

Risks and Opportunities Arising from DOJ's New "Compliance Counsel"
Continued from page 11

to make sure we have realistic expectations . . . and tough-but-fair ones in various industries.'"[10] He added: "'It doesn't do anyone good to have people wasting their compliance dollars on areas that are low risk.'"[11]

If and when the compliance expert takes up residence at DOJ, individual companies and industries will no doubt face important choices in terms of how they would like to work with DOJ on this benchmarking exercise. Companies that already participate in trade associations may wish to use those groups to bring certain information to DOJ's attention. Individual companies that have unique risk profiles may wish to respond proactively to any DOJ call for information, or even earlier, as the DOJ expert gathers preliminary information about compliance programs.

Companies and the DOJ alike will in turn face issues of how to handle the transmittal of confidential information about the operation of a compliance program, and how joint industry presentations can be made in a manner that avoids the risk of improper collusion. The very existence of a robust DOJ benchmarking exercise may cause some companies concern that providing honest and robust assistance in that exercise will cause DOJ to launch an investigation, or, to the contrary, that *not* participating in the benchmarking exercise will somehow draw DOJ's attention. How companies manage the dialogue with DOJ's expert in the benchmarking exercise – and how DOJ works to alleviate the concerns of those who choose to cooperate in the project or not – may thus present unique and potentially difficult challenges. That is true not only for companies that have recognized they have deficiencies and are working to redress them, but also for companies that have weak compliance programs but, for whatever reason, do not appreciate the weaknesses.

For the DOJ specifically, the new appointment also raises a number of potentially important issues. For example, coming as it does late in the second term of the Obama Administration, the appointment raises practical questions whether sufficient work can be done by the compliance expert to generate standards before a new Administration comes into office and possibly replaces the expert or otherwise amends or nullifies what the expert has done. Not only may any standards be repealed, any non-final charging decisions may later be changed.

Continued on page 13

10. *See* Schectman, note 1, *supra*.

11. *Id.*

Risks and Opportunities Arising from DOJ's New "Compliance Counsel"
Continued from page 12

If compliance program standards eventually are promulgated in formal or informal guidance, questions may also arise over whether those provide what the Supreme Court in *Chaney* identified as a "meaningful standard against which to judge the agency's exercise of discretion" in a manner that could provide a basis for judicial review under the Administrative Procedure Act or other law.[12] A company facing a charging decision that failed to give what it believed was the appropriate weight to efforts to implement a robust corporate compliance program may, depending on how any new standards are worded, have a substantial defense.[13] Other questions of both substance and process will undoubtedly arise as this interesting DOJ innovation takes shape.

Conclusion

Whatever role the DOJ compliance expert position ultimately plays, its creation signals that DOJ has recognized the need for fact-based input and consistency in the evaluation of a company's corporate compliance program. This innovation is not without its challenges, even without a corporate compliance defense. Nevertheless, the reform to DOJ's processes and standards for investigating, evaluating, and prosecuting FCPA and other corporate criminal matters does provide some reason for hope that genuinely robust corporate compliance initiatives will receive their due when the DOJ makes charging decisions, especially in situations involving rogue actions of employees who actively evade such risk-based and well-executed compliance programs.

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Continued on page 14

12. 470 U.S. at 830.
13. *See id.*

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents

The U.S. Court of Appeals for the D.C. Circuit has once again stepped into an ongoing fight between the proponent of a qui tam action and Kellogg Brown and Root Services, Inc. ("KBR") over privilege protections for documents related to an internal investigation.[1] In so doing, for the second time in a little more than a year,[2] the D.C. Circuit has issued a writ of mandamus sought by KBR to protect investigative materials from District Court-ordered disclosure. The ruling reaffirms the protections afforded to investigative materials, but at the same time highlights differences between the attorney-client privilege and work product immunity that warrant close attention by those conducting internal reviews, including reviews prompted by potential FCPA issues.

I. Background

The D.C. Circuit's ruling arises from an ongoing fight between KBR and Harry Barko ("Barko"), who has brought a lawsuit under the False Claims Act against KBR, Halliburton, Inc. and other federal contractors, alleging that the U.S. government was overbilled for hundreds of war-zone construction contracts awarded during the Iraq war. Prior to the suit being filed, KBR had conducted an internal investigation of the alleged billing misconduct, as required by statutory and contractual provisions imposed on government contractors.[3] That investigation had been overseen by KBR's in-house legal counsel, although some of the work, including interviews of KBR employees, had been performed by non-lawyers working under the direction of the lawyers.

Barko repeatedly has sought production of the investigative report and supporting documents (the "Investigative Materials") generated by KBR's review, and the District Court repeatedly had granted the request, initially ruling that the Investigative Materials were not privileged because the investigation was part of KBR's compliance program and its primary purpose was not the obtainment of legal advice.[4] As previously reported here, last summer the D.C. Circuit overturned

Continued on page 15

1. *In re Kellogg Brown & Root, Inc.*, No. 14-5319, 2015 WL 4727411 (D.C. Cir. Aug. 11, 2015) ("*KBR II*").
2. *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014) ("*KBR I*"); *see also* Helen V. Cantwell, Andrew M. Levine, Colby A. Smith, Bruce E. Yannett, Steven S. Michaels, and Blair R. Albom, "D.C. Circuit Upholds Privilege Protections," *FCPA Update*, Vol. 5, No. 12 (July 2014), http://www.debevoise.com/insights/publications/2014/07/fcpa-update (reporting on this earlier ruling).
3. *KBR I*, 756 F.3d at 756.
4. *United States ex rel. Barko v. Halliburton Co.*, 37 F. Supp. 3d 1, 5-6 (D.D.C. 2014).

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents
Continued from page 14

that ruling, emphatically reaffirming that investigations conducted pursuant to a company compliance program were privileged, as long as one of the significant purposes of the investigation was to obtain or provide legal advice.[5] On remand, however, the Court of Appeals in *KBR I* expressly said that Barko could present any other arguments he had timely asserted to overcome the privilege.[6]

II. The District Court's Rulings on Remand From *KBR I*

On remand from *KBR I*, Barko argued that KBR had put the investigative report and related materials "at issue" in the litigation when it argued, by implication, that it had conducted an internal investigation and then not changed any of its corporate conduct, as normally would happen if the investigation had found something unlawful. Barko also argued that he was entitled to fact work product uncovered by the review, because of his demonstrated need. The District Court ruled on the first issue on November 20, 2014 and addressed the second issue separately on December 17, 2014. In both instances, the District Court ordered production of at least some of the Investigative Materials.

In its November 20, 2014 ruling, the District Court held that KBR had waived privilege with respect to all of the Investigative Materials, because it had put the contents of the documents "at issue" as part of its defense.[7] The District Court found that an argument made by KBR in its summary judgment motion, based upon the testimony of KBR's Rule 30(b)(6) witness, constructed the following syllogism:

> First, whenever KBR has reasonable grounds to believe that a kickback or fraud had occurred, its contracts and federal regulation required it to report the possible violation. Second, KBR abides by this obligation and reports possible violations. Third, KBR investigated the alleged kickbacks that are part of Barko's complaint. Fourth, after the investigation of the allegations in this case, KBR made no report to the [g]overnment about an alleged kickback or fraud.[8]

Continued on page 16

5. *KBR I*, 756 F.3d at 758-59.
6. *Id.* at 764.
7. *United States ex rel. Barko v. Halliburton Co.*, No.1:05-cv-1276, ECF No. 205, at 23 (D.D.C. Nov. 20, 2014).
8. *Id.* at 17.

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents

Continued from page 15

This argument, the District Court concluded, "sought a positive inference" in KBR's favor and "create[d] an implied waiver" of any privilege or work product protections.[9] On that basis, the District Court ordered the production of all of the Investigative Materials that KBR had withheld.[10]

On December 17, 2014 the District Court issued a separate opinion requiring disclosure of some of the Investigative Materials, which it found to constitute "discoverable fact work product" that should be produced because Barko had established "substantial need."[11] In reaching this conclusion, the District Court first ruled that some of the Investigative Materials, including communications between legal counsel and the non-legal investigators conducting many aspects of the investigation who acted as counsel's agents, were not privileged to the extent they did not contain or reflect communications from company employees. Materials that did not constitute "communications" between attorney and client cannot be privileged, the District Court ruled, but can at most constitute attorney work product.[12]

"Because the District Court found Barko had shown a substantial need for these 'fact work product' documents, it required KBR to disclose the portions of the Investigative Materials that did not contain or reflect communications between attorney and client."

The District Court then found that summaries of KBR's subcontracts and of subcontractors' performance contained in reports written by the non-lawyer investigators were "fact work product" that could become discoverable upon a showing of substantial need.[13] Specifically, the District Court noted that witness lists were fact work product because they did not provide insight into

Continued on page 17

9. *Id.* at 23.

10. *Id.* In a related ruling, the District Court also found that KBR had waived privilege protection under Rule 612 of the Federal Rules of Evidence by allowing its Rule 30(b)(6) witness to review some of the Investigative Materials to prepare for his deposition and then testify in support of the syllogism used by KBR in its summary judgment motion. *Id.* at 23-26. The D.C. Circuit disagreed, finding that Barko himself had put the Investigative Materials at issue in the Rule 30(b)(6) deposition by requesting a witness who was knowledgeable about the investigation itself and not merely the underlying events. The witness, the Court of Appeals ruled, "had no choice but to review documents related to" the investigation. *KBR II*, at *5.

11. *United States ex rel. Barko v. Halliburton Co.*, No.1:05-cv-1276, 2014 WL 7212881, at *2 (D.D.C. Dec. 17, 2014).

12. *Id.* at *5.

13. *Id.* at *8, 10.

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents
Continued from page 16

the investigator's "strategy." Similarly, the District Court found "raw factual contract background material" to be fact work product because it did not reflect attorney strategy or opinions.[14] Because the District Court found Barko had shown a substantial need for these "fact work product" documents, it required KBR to disclose the portions of the Investigative Materials that did not contain or reflect communications between attorney and client.[15]

III. The D.C. Circuit Court's Opinion

Circuit Judge Robert L. Wilkins, writing for a unanimous appeals panel, disagreed with the District Court's conclusion that KBR had waived attorney-client privilege by placing the Investigative Materials at issue in the case. The Court of Appeals also found that the District Court incorrectly applied the work product doctrine in ordering some of the investigative work product to be produced.

According to the Court of Appeals, with respect to the first issue, KBR had not placed privileged materials at issue in its summary judgment pleadings. While KBR certainly had described its normal procedure in conducting investigations and reporting wrongdoing when found, and while KBR may have been hoping the Court would draw a "positive" inference from the fact that KBR had not reported wrongdoing in this case, the Circuit Court found that positive inference to be far from "unavoidable."[16] "[A]n alternative inference," Judge Wilkins wrote, "is that the investigation showed wrongdoing but KBR nonetheless made no report to the government."[17] Because KBR did not reveal the privileged conclusions reached by the investigation – which would have put the results of the investigation at issue and waived the privilege – KBR's syllogism supported neither the positive inference nor that alternative inference. In the words of the Court of Appeals:

> There's the rub: Where KBR neither directly stated that the COBC investigation revealed no wrongdoing nor sought any specific relief because of the results of the investigation, KBR has not based a claim or defense upon attorney's advice.[18]

As a result, according to the Court of Appeals, the District Court's ruling was clear and reversible error.

Continued on page 18

14. *Id.* at *7-8.
15. *Id.* at *10.
16. *KBR II*, 2015 WL 4727411 at *7.
17. *Id.*
18. *Id.* at *8.

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents

Continued from page 17

With respect to the second issue, the Court of Appeals found that the District Court's description of the legal difference between the attorney-client privilege and work product protection in the context of an investigation was sound, but it found that the District Court had applied that analysis incorrectly when it ordered KBR to produce some of its work product. "[M]aterials produced by an attorney's agent [such as the non-lawyer investigators in the KBR investigation] are attorney-client privileged only to the extent they contain information obtained from the client."[19] Otherwise, the Court of Appeals said, communications from the investigator to the in-house attorney are "inherently work product."[20] With this distinction in mind, the Court of Appeals found that the District Court had misapplied the law in two ways. First, the Circuit Court found that contrary to the District Court's ruling, many of the documents at issue contained summaries of witness statements to which the attorney-client privilege applied.[21]

Second, the Court of Appeals found that the District Court's order required disclosure of "mental impressions of the investigators" contained in background materials, which were not fact work-product, but opinion work product. Opinion work product is afforded a higher level of protection than fact work product, for which the District Court's finding of substantial need was insufficient.[22] The Circuit Court therefore held that there was no basis for producing such opinion work product and reversed that portion of the District Court's ruling.[23]

IV. Implications for Conducting Internal Investigations

In many respects, the D.C. Circuit's opinion did not announce any novel concepts or break significant new ground. To be sure, the ruling reaffirmed that "attorney-client privilege protects confidential employee communications made during an internal investigation led by company lawyers."[24] As *KBR II* also reaffirms, the D.C. Circuit holds the view that "communications that do not involve both attorney and client, are unprotected" by the attorney-client privilege.[25] In this case, the Investigative Materials were preserved from production by a combination of attorney-client privilege (covering the communications made by employees to investigators

Continued on page 19

19. *Id.* at *10.
20. *Id.*
21. *Id.* at *11.
22. *Id.*
23. *Id.* at *11. The Court of Appeals did not reach the question of whether the District Court's "substantial need" analysis was appropriate.
24. *Id.* at *1 (citing *Upjohn Co. v. United States*, 449 U.S. 383 (1981)).
25. *Id.* at *10 (quoting *In re Sealed Case*, 656 F. 2d 793, 809 (D.C. Cir. 1982) (ordering production of a general counsel's files that did not involve any communications with clients)).

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents
Continued from page 18

during the course of the investigation) and work product immunity (covering the impressions of the investigators and communications among investigators that did not reveal client communications).[26] But that protection may not be available in every case, because investigations may be undertaken in circumstances where litigation is not pending or anticipated – a necessary prerequisite for work product protection.[27] Indeed, in the KBR case, the very first District Court ruling ordering the production of documents said that KBR had not conducted its investigation in anticipation of litigation.[28] Rather, the District Court found the investigation had been conducted in the ordinary course of business to satisfy regulatory obligations and before Barko's lawsuit had been unsealed.[29] In *KBR I*, the Court of Appeals, having found the documents to be protected by the attorney-client privilege, never expressly addressed that conclusion. In its December 17, 2014 ruling, the District Court, without further explanation, changed course and ruled that KBR's investigative reports were prepared in anticipation of litigation and therefore qualified for work product protection.[30]

In other cases, however, where an internal investigation may be conducted for regulatory or corporate governance reasons, rather than in response to or in anticipation of litigation, the D.C. Circuit's *KBR II* ruling suggests that those conducting internal investigations may wish to exercise particular care when engaging in communications that do not involve communications between attorney and client. In light of this, companies and compliance departments should consider the following "best practices" when undertaking an internal investigation:

- Developing a written work plan that clarifies, where appropriate, that at least one purpose of the investigation is to provide legal advice to the corporate client and that the legal team, which may include non-lawyers, is engaging in the review for that purpose.
- Documenting, where appropriate, that the internal investigation is being undertaken in anticipation of possible litigation or in response to pending litigation (which may include possible or pending regulatory actions as well as civil litigation), and making note of the specific type of litigation that the corporation reasonably believes may be possible.

Continued on page 20

26. *Id.* at *10-12.
27. Fed. R. Civ. P. 26(b)(3).
28. *Barko*, 37 F. Supp. 3d at 6.
29. *Id.*
30. *Barko*, 2014 WL 7212881, at *6.

D.C. Circuit Again Issues Mandamus to Protect Internal Investigation Documents
Continued from page 19

- Clarifying within communications among the team how the communication relates to the client's request for legal advice or to the provision of legal advice to the client (*e.g.*, note that the communication is in response to a client request, reflects a client request, contains information from the client to be used in responding to the client's request, reflects advice provided to the client, or otherwise reflects communications between the client and the legal team).

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Continued on page 21

How Companies Can "Self-Clean" Corruption, Thanks to EU Reforms[1]

The EU rules on public procurement include provisions excluding companies convicted of corruption from EU member states' governmental procurement contracts. Following recent reforms, there are some new rules pertaining to exclusion (both mandatory and discretionary) and a new regime for "self-cleaning" under a new EU Directive 2014/24.

It is widely recognized that there are a number of problems with the one-size-fits-all approach that the EU had adopted on corruption and illegality within public procurement prior to this reform. Firstly, the harshness of exclusion from public contracts made the consequences of a corporate conviction so extreme that governments had sometimes shied away from prosecuting companies for corruption.

Secondly, the one-size-fits-all approach did not recognize that companies can change their behavior and provided no incentive for them to do so.

Thirdly, different countries may have different rules about corporate criminal responsibility, meaning that employee conduct might render a company criminally liable in one country but not in another. This could lead to inconsistent and unfair results for a company that ultimately faces debarment from public procurement in a jurisdiction with relatively lax standards for prosecution while another company facing similar difficulties elsewhere continues business as usual.

In an attempt to address these problems, last year the EU passed Directive 2014/24, which is due to be implemented by all EU member states by April 2016. The "self-cleaning" provisions of the new EU Directive allow firms convicted of corruption to continue bidding for and participating in public contracts if they can prove that they have sufficiently remediated and changed their behavior.

Thus, although the penalties that may be applied for an act that could result in debarment may be harsh, companies have a way to avoid debarment and countries have a way to avoid imposing the corporate death penalty on companies. The United Kingdom has already implemented this EU Directive through the Public Contracts Regulations 2015, which entered into force early this year, and other EU member states will follow suit. An ordinance related to its implementation is currently in the consultation stage in France.

Continued on page 22

1. The below article was first published at cdr-news.com on August 6, 2015.

How Companies Can "Self-Clean" Corruption, Thanks to EU Reforms
Continued from page 21

The overall effect of the new Directive will be two-fold. Firstly, companies across Europe will have a much greater incentive both to self-report violations and to conduct real remediation. Secondly, European governments may find themselves less constrained from prosecuting companies for corruption.

Provisions on mandatory and discretionary exclusion from public contracting and the "self-cleaning" cure

EU Directive 2014/24 outlines mandatory and discretionary grounds for exclusion from public contracting, sets maximum time lengths for each type of exclusion, and also contains provisions relating to "self-cleaning." The Directive also introduces provisions allowing public authorities to admit firms which would be otherwise excluded but have taken sufficient corrective "self-cleaning" measures to ensure that the relevant offenses or misconduct that triggered their exclusion will not be repeated. Prior to this EU Directive, only Austria, Germany and Italy had implemented similar "self-cleaning" measures.

A business must be excluded from public contracting if it is convicted or a member of its administrative, management, or supervisory body, or a person with powers of representation, decision or control in its organization is convicted of an offense enumerated in Article 57 of the EU Directive. Conviction for some offenses including participation in a criminal organization, corruption, fraud and money laundering has already been listed as cause for mandatory debarment in Directive 2004/18/EC.

When implementing the EU Directive, member states may provide that the EU Directive's mandatory exclusion rules may be derogated from and that public contracts may be awarded, on an exceptional basis, to a company that would otherwise be excluded from a public contracting bidding process where overriding requirements in the general interest make the award of a contract to such a company indispensable.

An EU member state may decide to make the discretionary grounds of exclusion truly discretionary at the national level or may require their contracting authorities to exclude based on one of the "discretionary" exclusion grounds provided for by the Directive.

According to Article 57, paragraph 4 of EU Directive 2014/24, contracting authorities may exclude or may be required to exclude a business from participation in a procurement procedure when violations of environmental, social or labor law occur, in situations of insolvency or grave professional misconduct that renders

Continued on page 23

Continued from page 22

the bidder's integrity questionable, where there is collusion between bidders aimed at distorting competition, and due to conflicts of interest. A new discretionary ground of exclusion also provides that a bidder may be excluded based on its prior performance.

Article 57 of the EU Directive also contains new temporal provisions on exclusion, which include a requirement that EU member states must establish a maximum period of exclusion that may apply if "self-cleaning" measures are not taken by a business to rehabilitate itself and demonstrate its reliability and if a period of exclusion of a company has not been set by a final judgment of conviction.

"In order to benefit from 'self-cleaning,' the business shall prove that it has paid, or undertaken to pay, compensation in respect of damage caused by the damage/misconduct, clarified the facts and circumstances by collaborating with the investigating authorities and taken concrete measures to prevent further criminal offenses/misconduct."

For mandatory exclusions, the maximum period of exclusion that a state may establish is five years from the date of the conviction and, for discretionary exclusions, the maximum period is three years from the date of the relevant event, subject in both cases to the "self-cleaning" provisions described below and other applicable exceptions.

The "self-cleaning" provisions of EU Directive 2014/24 are found in Article 57, paragraph 6. Any business that faces exclusion on mandatory or discretionary grounds shall not be excluded from public procurement bidding if the contracting authority considers that the measures taken are sufficient enough after taking into account the gravity and the particular circumstances of the misconduct that would have otherwise resulted in debarment.

In order to benefit from "self-cleaning," the business shall prove that it has paid, or undertaken to pay, compensation in respect of damage caused by the damage/misconduct, clarified the facts and circumstances by collaborating with the investigating authorities and taken concrete measures to prevent further criminal offenses/misconduct.

Continued on page 24

Continued from page 23

If the contracting authority considers the "self-cleaning" measures taken to be insufficient, it shall give the business a statement of the reasons for its decision to decline "self-cleaning." Notably, EU member states retain a certain amount of discretion in deciding how to implement the "self-cleaning" provisions and the appropriate preventative measures will differ depending on the size of the business concerned.

Examples of appropriate "self-cleaning" measures could include the following: immediate dismissal of employees who broke the law, prevention of future misconduct through the introduction of ethical codes of conduct, introduction of principles of good conduct in employment contracts, and adoption of internal regulations on liability and compensation for damages in case of non-compliance with the relevant legal provisions. In order for any of these measures to be credible, they must be monitored.

If the business has been excluded for a specific period set by a final judgment of a criminal conviction from participating in procurement or concession award procedures, it shall not be entitled to make use of the possibility to take the "self-cleaning" measures specified above until after that period of exclusion has come to an end.

Practical consequences of the new self-cleaning provisions

The new "self-cleaning" provisions of EU Directive 2014/24 may promote several desirable policy consequences. These consequences relate to how EU member states regulate, monitor and control compliance with their anti-corruption policies and, perhaps even more importantly, provide companies with strong incentives to comply with the law and to implement preventative compliance programs.

The new provisions will provide companies with incentives to improve their anti-corruption policies and other compliance practices that would form part of an appropriate "self-cleaning" response when problems are identified that, absent company-initiated "self-cleaning" measures, could result in mandatory or discretionary debarment.

Although some companies may wait until an issue is identified that may potentially lead to debarment before putting into place a reliable compliance program, many companies will view the availability of the "self-cleaning" remedy as a reason to maintain a strong compliance program with the view to preventing any issues that might result in later discussions with authorities about "self-cleaning."

Of course, companies have other incentives to maintain strong compliance programs, because, in some jurisdictions, the very existence of a good compliance

Continued on page 25

How Companies Can "Self-Clean" Corruption, Thanks to EU Reforms
Continued from page 24

program can be a defense to corporate prosecution or a very strong bargaining card that can lead to a more acceptable negotiated outcome than would have otherwise been available.

The "self-cleaning" provisions of the new EU Directive will allow EU member states to pursue policy objectives related to preventing corruption in economic life while avoiding compromising sound economic policy objectives that serve the interests of everyone in society. In particular, the provisions of EU Directive 2014/24 may eventually result in a greater willingness on the part of EU member states to prosecute corporations on charges for which, if they had been prosecuted prior to the implementation of the new "self-cleaning" provisions of the Directive, would have resulted in the companies' mandatory debarment from public contracting and therefore possibly in adverse economic consequences for society as a whole.

As a result of the EU Directive, contracting authorities in EU member states may allow corporations to avoid debarment through implementing "self-cleaning" measures and more prosecutions may, as a consequence, go forward. On a related note, the use of deferred prosecution agreements or other negotiated outcomes that are conditioned on "self-cleaning" measures may likewise increase in those jurisdictions in which the use of such agreements is possible.

The actual impact of the "self-cleaning" provisions of EU Directive 2014/24 and any evaluation of their impact on the adoption of compliance programs by companies or the pursuit of prosecution by public prosecutors within EU member states remains speculative. It is, however, certain that the incentive structure behind the EU Directive's "self-cleaning" provisions is properly aligned with the public interest because the Directive incentivizes compliance by companies with the law and allows EU member states to avoid imposing debarment on companies that "self-clean."

This incentive for states to allow companies to avoid debarment is desirable because its proper operation would provide clear societal benefits by allowing EU member states to avoid penalizing a company to the extent that the jobs and economic benefits created by the company may be endangered.

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