Executives at Risk: Navigating Individual Exposure in Government Investigations – Spring 2017

White Collar Alert
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Several recent developments in significant government investigations highlight the aggressive tactics prosecutors are deploying and the risks faced by corporate executives:

- German authorities raided an outside law firm retained by Volkswagen's supervisory board in the emissions investigation, as well as the offices of the company's Audi division.
- U.S. agents conducted a multi-agency raid of three Caterpillar Inc. offices in Illinois related to the company's effort to shift billions in profit from the U.S. to a Swiss affiliate to secure a favorable tax rate.
- The founding partners of the law firm at the center of the Panama Papers scandal were arrested by Panamanian authorities on money laundering charges related to Brazil's ongoing "Operation Carwash" corruption investigation.
- DOJ's Antitrust Division raided the domestic shipping container industry's trade association and issued subpoenas to numerous companies in the industry.

Despite these aggressive tactics by prosecutors, we note that there have been relatively few charges brought against corporate executives in major government investigations this spring. For example, no executives were prosecuted on Foreign Corrupt Practices Act (FCPA)-related charges. In cartel cases, only one executive has been charged on antitrust charges in a global investigation and only a handful have been prosecuted in smaller domestic investigations.

Finally, we highlight several noteworthy sentencings and court rulings related to privilege issues that should interest corporate executives.

Noteworthy Investigations

Caterpillar Tax Scandal

Feds Raid Caterpillar in Multi-Agency Tax Investigation : In March, Internal Revenue Service (IRS) Criminal Investigation Division agents, along with representatives of the Commerce Department and the Federal Deposit Insurance Corporation, raided three Caterpillar Inc. offices in Illinois. The construction equipment company disclosed in a press statement that the raid likely related to export filings made by its Swiss affiliate, CSARL. In 2014, the Senate Permanent Subcommittee on Investigations concluded that CSARL had been used primarily as a tax strategy to shift billions in profit from the U.S. to Switzerland, where Caterpillar had negotiated a highly favorable corporate tax rate. Caterpillar subsequently disclosed in a 10-K that it had received grand jury subpoenas related to its CSARL tax strategy and that the IRS had asserted that the company owed about $1 billion in unpaid taxes and penalties. In its most recent 10-K, Caterpillar disclosed that the amount in dispute had increased to $2 billion.

One day after the raid, shareholders filed a federal securities class action lawsuit against Caterpillar in the Northern District of Illinois. The lawsuit alleges that Caterpillar misled the public about its use of foreign subsidiaries to avoid U.S. taxes.

Emissions Scandals

Volkswagen's Outside Counsel Raided by German Authorities : In March, German authorities raided the Munich offices of Jones Day, the law firm hired by Volkswagen's supervisory board in late 2015 to conduct an internal investigation into the company's emissions scandal. Local press reported that the Munich prosecutor's office conducted the raid because of a lack of cooperation by Volkswagen. Volkswagen criticized the raid – which took place one day after authorities raided the German offices of Audi (a division of Volkswagen) – as "a clear breach of the principles of the rule of law."

Following the raid, Volkswagen initiated proceedings to prevent prosecutors from reviewing the materials seized from Jones Day. Both a Munich local court and a regional court ruled that the raid was lawful. Volkswagen has pledged to appeal.

Volkswagen Executive Sits in Jail Awaiting Trial : As previously reported in January, Oliver Schmidt, Volkswagen's top emissions compliance manager for the U.S., was arrested in the United States on federal conspiracy charges related to the falsification of emissions data. The U.S. District Court for the Eastern District of Michigan denied Schmidt's request for pretrial bond. Schmidt, a German national, is the lone Volkswagen executive currently in U.S. custody. Germany does not extradite its own citizens. The Sixth Circuit affirmed Schmidt's continued detention and his trial is slated to begin in January 2018. As previously reported, Robert Liang, a co-defendant in the case, pled guilty in September 2016 and is scheduled to be sentenced in July.

Daimler Raided in Connection with its Own Emissions Investigation : German prosecutors also raided the offices of Daimler AG seeking evidence regarding whether the company falsified emissions documents. The German prosecutors said in a statement that 23 prosecutors and 230 personnel searched 11 different Daimler offices in May.

Panama Papers Scandal

Lawyers Linked to Panama Papers Arrested in Petrobras Investigation : In February, Panamanian prosecutors raided the offices of Mossack Fonseca, the law firm at the center of the Panama Papers scandal and arrested name partners Juergen Mossack and Ramon Fonseca on money laundering charges. Prosecutors are investigating possible links between the law firm and Odebrecht S.A. (Odebrecht), a global construction conglomerate based in Brazil. Prosecutors alleged that the law firm set up offshore accounts that allowed Odebrecht to pay bribes and that the firm destroyed evidence of the bribery scandal. Fonseca told reporters that Mossack Fonseca has no connection to Odebrecht. The firm has said that it is cooperating with authorities. Though the two lawyers were originally denied bail because they were considered flight risks, in April 2017, Mossack and Fonseca were released after paying $500,000 each. As reported in Miller & Chevalier's FCPA Winter Review 2017, Odebrecht and its petrochemical producer subsidiary, Braskem S.A., resolved bribery allegations with Brazilian, U.S., and Swiss authorities related to Brazilian state-owned oil company Petrobras in a coordinated settlement in December 2016, resulting in fines and other payments exceeding $3.5 billion.

Foreign Corrupt Practices Act (FCPA)

SEC Sues Former Och-Ziff Executives Who Allegedly Orchestrated Bribery Scheme : In January, the Securities and Exchange Commission (SEC) filed a civil FCPA suit against former Och-Ziff Capital Management LLC (Och-Ziff) executives Michael Cohen and Vanja Baros, alleging that the pair directed Och-Ziff to pay tens of millions of dollars in bribes to African government officials in order to secure preferential treatment for the company. Cohen, former executive managing director of the hedge fund, and Baros, a former Och-Ziff analyst, are the fourth and fifth individuals to be charged in the scheme. Last year, the company's CEO, Daniel Och, agreed to pay $2.2 million to settle SEC allegations in connection with the scandal and the company's CFO, Joel M. Frank, similarly agreed to pay an undisclosed amount. As we previously reported, Samuel Mebiame, the son of the former prime minister of Gabon, pled guilty in December 2016 to criminal charges of conspiring to violate the FCPA while acting as an Och-Ziff contractor.

Magyar Telekom Executives Settle Bribery Allegations with the SEC : In April, two former executives of Hungarian telecommunications firm Magyar Telekom settled civil FCPA charges, brought by the SEC in December 2011, that they participated in a scheme to bribe government officials in Macedonia in exchange for favorable treatment for the company's Macedonian subsidiary. Former CEO Elek Straub and former Chief Strategy Officer András Balogh agreed to pay penalties of $250,000 and $150,000, respectively and consented to five-year bars from serving as officers or directors of public companies. In February, Tamas Morvai, the company's former Director of Business Development and Acquisitions, settled claims that he falsified books in connection with the bribery scheme. He agreed to pay a $60,000 penalty.

Cartel

Prosecutions of Executives in DOJ Cartel Investigations Slow : Prosecutions of executives in international and domestic cartel investigations are off to a slow start in 2017. Since our last report, the Department of Justice (DOJ) has obtained only two guilty pleas from corporate executives in international cartel investigations. In February, Satoshi Okubo, an executive of Matsuo Electric Co. Limited, pled guilty to fixing the prices of electrolytic capacitors and agreed to a prison term of a year-and-a-day. This is the first guilty plea in the capacitors investigation, which began more than three years ago. Also in February, auto parts executive Futoshi Higashida, the former president of a U.S. joint venture of a Japanese auto body sealing product supplier, pled guilty to obstruction charges and agreed to serve 14 months in prison. To date, four out of seven executives indicted in international cartel investigations in 2017 have pled guilty. While this is a slight increase in the percentage of executives pleading guilty over our previous reports, it is still far lower than the national average in criminal cases.

On the domestic front, DOJ continues to dedicate its resources to investigating allegations of bid-rigging in localized real estate foreclosure auctions. Also in January, a jury convicted four school bus company owners for their participation in bid-rigging and fraud conspiracies at an auction for public school bus transportation services in Puerto Rico. These convictions represent DOJ's only successful domestic cartel prosecutions of individuals thus far in 2017.

DOJ Launches Domestic Ocean Shipping Container Investigation : In March, DOJ's investigation of the ocean container shipping industry became public. Executives from some of the world's largest container shipping companies, including A.P. Moller-Maersk, MSC, Hapag Lloyd, Evergreen, and Orient Overseas Container Line were served with subpoenas.

Government Contracts Fraud

Executives to Plead Guilty to Defrauding Army on Humvee Contracts : In March, the former co-owners of a company that makes armor for combat vehicles were charged with defrauding the U.S. Army of more than $6 million. Brothers Thomas and John Buckner, co-owners of Pennsylvania-based Ibis Tek, allegedly inflated costs under a U.S. Army Tank Automotive and Armaments Command (TACOM) contract for Humvee windows by using a dummy corporation to buy cheap window frames from China, then "purchasing" the windows from their own company, only to then submit the false invoices to TACOM. They also allegedly sold scrap aluminum metal left over from the manufacturing process and kept the proceeds, instead of crediting that money back to the Army as required. The company's CFO, Harry Kramer, was also charged with participating in the scheme. The defendants

reportedly indicated they intend to plead guilty.

Extradited Israeli Defense Contractor Pleads Guilty to Foreign Military Financing Fraud : In March, the former owner of an Israeli-based defense contractor pled guilty to participating in multiple schemes to defraud the U.S. Foreign Military Financing program (FMF), which provides funds to foreign governments to purchase military equipment and services from U.S. companies. As previously reported, Yuval Marshak was extradited from Bulgaria in October 2016 to face charges in U.S. federal court. Marshak admitted to falsifying bid documents, causing false certifications to be made to the U.S. government, and using a U.S. company to launder proceeds of his fraud. He will be sentenced on June 12, 2017.

Securities Fraud

Dewey & LeBoeuf CFO Convicted of Fraud and Conspiracy; Former Executive Director Acquitted : The Manhattan District Attorney's Office's second attempt to hold senior executives of the now-bankrupt law firm Dewey & LeBoeuf LLP criminally liable in the wake of the firm's collapse in 2012 resulted in partial victory. In May, a jury found Joel Sanders, the firm's former CFO, guilty on two felony fraud charges and a misdemeanor count of conspiracy. The jury acquitted Stephen DiCarmine, the firm's former Executive Director, of all charges. A 2015 trial against Sanders, DiCarmine, and the firm's former Managing Partner, Steven Davis, ended primarily in a mistrial. In early 2016, Davis entered into a deferred prosecution agreement with the district attorney's (DA) office, leaving only Sanders and DiCarmine to stand trial again. Post-trial, jurors indicated that the DA provided insufficient evidence connecting DiCarmine with the purported scheme to defraud. Sanders faces a maximum prison sentence of four years.

Tax

IRS Staffing and Criminal Cases Decline : In its recently released 2016 annual report, the IRS Criminal Investigation Division reported a steady decrease in criminal investigations, which correlates to a decline in staffing. The IRS initiated almost 500 fewer criminal cases in the areas of identity theft, money laundering, and other financial investigations in fiscal year 2016 than in 2015, while staffing has dropped by about 20 percent. On March 16, the Trump administration released a budget blue print that proposes to reduce the IRS's budget by an additional $239 million. In fiscal year 2016, the IRS's actual expenditures were $11.7 billion, down from $13.5 billion (inflation adjusted) in 2010.

Federal Employment Tax Enforcement Initiative's Future is Unknown : DOJ Tax Division's push on civil and criminal employment tax enforcement may be losing steam. In March, Richard Tatum, owner of Texas-based Associated Marine & Industrial Staffing Inc. (AMI), pled guilty to failing to pay $18 million in employment taxes withheld from AMI employees' paychecks and using the withheld funds for personal benefit, including travel to Las Vegas, Hawaii, and France. Tatum faces a statutory maximum sentence of five years in prison. A recent report from the Treasury Inspector General for Tax Administration found that because IRS revenue officer resources are dwindling, "egregious" employment tax noncompliance has steadily increased.

Tax Court Increases Incentive for Employees to Blow the Whistle on Employer's Tax Misdeeds : In January, the Tax Court issued final decisions in *Whistleblower 21276-13W v. Commissioner* and *Whistleblower 21277-13W v. Commissioner* and directed the IRS to pay $17 million to a married couple who blew the whistle on a $74 million corporate tax fraud scheme by their employer. The court ruled that the couple's award should be based not simply on the amount of unpaid taxes collected by the IRS, but also the amount of criminal fines and civil forfeitures collected by the government. This interpretation of "collected proceeds" (see 26 U.S.C. § 7623(b)(1)) significantly increases the potential award amount for tax whistleblowers. Under the program, individuals who provide information to the IRS regarding individuals who fail to pay taxes owed receive up to 30 percent of all proceeds collected by the government (with no cap).

Obstruction

Tour Bus Executive Sentenced to 15 Months for Obstruction : A former vice president for a bus company operating tours in New York City was sentenced to 15 months in March 2017 after pleading guilty to concealing and attempting to destroy documents

related to a civil antitrust case. As previously reported, Ralph Groen of Coach USA Inc. (Coach) instructed employees to destroy back-up tapes with emails relevant to the litigation and made false statements under oath. The government alleged that a joint venture created by Coach and City Sights LLC resulted in an unlawful monopoly in the city's bus tour market. The companies settled the civil lawsuit in November 2015 and agreed to pay $7.5 million in disgorgement and other penalties. Groen and the government agreed that the advisory sentencing guideline range was 15-21 months. The probation department, however, argued for an additional two-point enhancement – resulting in a guideline range of 21-27 months – on grounds that Groen's offense conduct involved essential or especially probative records. Nevertheless, the court imposed a sentence of 15 months.

Noteworthy Sentencings

Court Applies Defense-Friendly Loss Calculation, Gives Executives Low Sentences in SBA Fraud Case : Walter Crummy, part owner of MCC Construction Corporation, pled guilty in the U.S. District Court for the District of Columbia to fraudulently obtaining contracts that were set aside for small disadvantaged businesses under a program administered by the Small Business Administration (SBA). Crummy used another company, Far East Construction (Far East), as a pass-through that would obtain the contracts and then subcontract them to MCC. Michelle Cho, an officer of Far East, also pled guilty for her role in the scheme. At sentencing, the government argued that the monetary loss for the crime should be equal to the face value of the contracts at issue – $1.6 million. The defense countered that the loss amount should be offset by the value of the services MCC provided to the government. The court ruled that while a company awarded a contract could be said to receive a benefit of sorts, this was not a "government benefit" akin to the examples listed in the sentencing guidelines.

As we have previously discussed, the determination of what constitutes a "government benefit" is an issue that has divided the federal courts. Under the defense-friendly view adopted in this case, the general rule of loss calculation applied and the loss amount was calculated as the value of the contract minus the value of services rendered to the government. Because MCC *lost* money on the contract, and because the court was presented with no evidence of the fair market value of the services rendered, the loss amount was deemed zero. Crummy was sentenced to 12 months of probation and ordered to pay $105,000 in forfeiture. Cho was sentenced to six months in prison, to be followed by 24 months of supervised release. Cho was also ordered to pay $170,000 in forfeiture and $35,000 in fines.

More Ex-Rabobank Traders Sentenced Well Below Sentencing Guidelines in LIBOR Manipulation Investigation : After entering guilty pleas, two more former Rabobank traders—Lee Stewart and Takayuki Yagami—received time-served sentences for their roles in a conspiracy to manipulate London Interbank Offer Rate (LIBOR). Both cooperated with the government and testified at trial against their co-defendants. In its sentencing memoranda for Stewart and Yagami, the government highlighted that both men had waived extradition, saving "judicial and prosecutorial resources." In Yagami's case, the government noted that he was "the first person in the world to plead guilty to LIBOR manipulation and to agree to cooperate." As we previously reported, fellow ex-Rabobank traders Paul Robson and Paul Thompson were sentenced to time served and three months in prison, respectively, in the LIBOR manipulation investigation.

Three Aviation Executives Receive Modest Sentences for FCPA Violations : In February, three executives of U.S. aircraft maintenance company Hunt Pan AM Aviation were sentenced after pleading guilty to conspiring to violate the anti-bribery provisions of the FCPA, among other charges. As previously reported, the executives participated in a $2 million bribery scheme to win aircraft parts and service contracts in Mexico. All three defendants — Douglas Ray (the company's President), Daniel Perez (the Director of Maintenance), and Kamta Ramnarine (General Manager and former President) —faced a maximum of five years in prison. Ray was sentenced to 18 months in jail and ordered to pay $590,000 in restitution. Perez and Ramnarine were both sentenced to three years' probation.

CEO Receives 12.5-Year Prison Sentence for $30 Million Bank Fraud Conspiracy : In March, Aaron Wider, former CEO of a mortgage lending bank, was sentenced to 150 months in prison after a jury found him guilty of conspiracy to commit bank fraud. As CEO of HTFC Corp., Wider and his company falsely claimed that the mortgages they sold on the secondary market were backed by real property and the assets of mortgagees. DOJ argued that the loss was approximately $22.5 million and sought the statutory

maximum sentence of 30 years imprisonment. Wider challenged the government's calculation on the grounds that he caused no actual loss because the money received was used to renovate properties. In addition to the 150-month sentence, Wider was ordered to pay $22.5 million in restitution.

Bitcoin Trader's Father Receives Below-Guidelines Sentence for Obstruction After Showing Remorse : In January, the father of a Bitcoin operator who pled guilty to operating an illegal bitcoin exchange received no jail time for obstruction charges related to his son's scheme. Michael Murgio pled guilty in October 2016 to conspiring to obstruct the National Credit Union Administration's examination of a credit union allegedly used as a front for his son to launder money. His son, Anthony Murgio, pled guilty in January to operating an illegal bitcoin exchange that processed more than $10 million in illegal Bitcoin transactions. The father, who faced a guidelines range of 10 – 16 months, was sentenced to probation. During sentencing, the district court noted that he expressed "real and substantial" remorse.

Privilege Issues

Judge Denies Common Interest Privilege in FIFA Case : In March, a federal magistrate judge denied a claim of common interest privilege between the South American soccer confederation CONMEBOL and its former president, Juan Angel Napout, stemming from the FIFA corruption investigation. Napout was indicted in December 2015 along with 16 other FIFA officials on racketeering, wire fraud, and money laundering-related charges, among other offenses. Shortly thereafter, U.S. officials seized thousands of documents from CONMEBOL. Napout asserted that the common interest doctrine, based on an agreement he had with CONMEBOL, prevented the government from keeping the documents. The agreement was made orally and confirmed in email correspondence between lawyers. The judge rejected Napout's argument, finding that a target of a government investigation (here, Napout) and the victim of the purported scheme (CONMEBOL) cannot have a "common interest." Multiple executives have pled guilty in connection with the FIFA corruption scandal, as we previously reported.

Two Recent Court Decisions Undermine Privilege Protections for Executives Interviewed in Investigations : The first decision, issued by the U.S. District Court for the District of Columbia, held that public disclosure of the results of an internal investigation conducted for the Washington Metropolitan Area Transit Authority (WMATA) resulted in subject matter waiver of the attorney-client privilege covering the interview memoranda used to compile the report. The court also concluded that the interview memos did not qualify for work product protection because even though WMATA had been threatened with legal action, it waited more than two years to hire outside counsel to conduct the investigation – meaning that it was not reasonable to assume WMATA continued to believe litigation was possible and the investigation was therefore not conducted "in anticipation of litigation."

In the second case, England's High Court of Justice ruled that mining group Eurasian Natural Resources Corp. (ENRC) must produce to the UK's Serious Fraud Office (SFO) documents the company claimed were privileged, including attorneys' notes of employee interviews conducted during the company's internal investigation. The SFO sought the documents as part of its criminal investigation into allegations of fraud, bribery, and corruption. The court largely rejected ENRC's claims of legal professional privilege, holding that the privilege does not apply when a document is not prepared for the sole or dominant purpose of conducting adversarial litigation. ENRC was required to produce the bulk of the contested documents because, the court found, the investigation was a fact-finding exercise.

Government Policies & Guidance

DOJ Issues Guidance on Evaluating Corporate Compliance Programs : In February, the DOJ Fraud Section issued guidance on its "Evaluation of Corporate Compliance Programs." The document highlights the "important topics and sample questions" that the Fraud Section considers when evaluating corporate compliance programs, listing 11 issues that the Fraud Section might consider. One such consideration is the conduct of senior and middle management and what compliance oversight was available to the board of directors. The document states that the Fraud Section will consider whether senior leaders have encouraged or discouraged the type of misconduct at issue, whether they did so through words or actions, how senior leaders modelled proper behavior, and what steps senior leaders have taken to demonstrate their commitment to compliance.

Executives Face Less Certainty with Antitrust Division's Leniency Program : In January, DOJ's Antitrust Division updated its "Frequently Asked Questions About the Antitrust Division's Leniency Program and Model Leniency Letters ," which provides guidance to companies and executives regarding the division's leniency program. Under the new FAQs, current executives of a corporate leniency recipient do not automatically qualify for immunity under Type B Leniency, which applies when companies report antitrust activity *after* the Division has learned about the activity from other sources. Some experts opine that the change discourages companies controlled by executives involved in the misconduct from seeking leniency. The FAQs could also create less certainty for former executives. Under the old FAQs, leniency for former executives of a leniency recipient was discretionary, not automatic. Under the FAQs, former executives are only eligible for leniency if they provide "noncumulative cooperation against remaining potential targets," or when their cooperation is necessary for the leniency applicant to make a confession that would qualify for leniency. Whether the FAQ modifications represent a substantive change in DOJ policy, or merely seek to conform outdated guidance to existing practice, is the subject of debate.

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