Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

PTC Case Offers Lessons On FCPA Self-Disclosure

Law360, New York (February 23, 2016, 10:19 AM ET) --

James M. Koukios

Lauren A. Navarro

In 2015, the U.S. Department of Justice made more news for the corporate Foreign Corrupt Practices Act cases that it did not bring than for the two that it did bring: Nine times last year, the DOJ declined to join corporate FCPA resolutions brought by the U.S. Securities and Exchange Commission. This led some observers, including us, to wonder what had caused the “great divide” between DOJ and SEC.

When asked in late 2015 whether there had been a “slowdown” in DOJ FCPA enforcement, Assistant Attorney General Leslie Caldwell stated that the Criminal Division was focusing on “bigger, higher impact” FCPA cases that involve bribery in multiple countries or wrongdoing by senior executives.[1] And indeed, the SEC resolution papers indicated that many of the nine SEC-only enforcement actions involved relatively small penalties and bribery that was generally contained to one foreign country. Many of those actions also included a self-disclosure, cooperation, or both.

In light of this, and because of the availability of a noncriminal remedy in the form of the SEC resolution itself, one could infer that in several of these SEC-only cases from 2015, the DOJ exercised its discretion under the Federal Principles of Prosecution of Business Organizations and declined to pursue a criminal resolution. Prior to Feb. 16, 2016, it appeared that DOJ might be following a similar course this year, as it declined to join the two SEC corporate FCPA resolutions brought up to that point.

But on Feb. 16, the DOJ and SEC brought parallel FCPA corporate resolutions involving Massachusetts-based issuer PTC Inc. and two of its wholly owned Chinese subsidiaries under circumstances that, at least at first glance, seemed similar to the cases that DOJ declined to join in 2015 and earlier in 2016: a relatively small penalty and bribery contained to one foreign country, plus self-disclosure and cooperation.

So what was different about the PTC case that made DOJ pursue its own resolution? The answer appears to be the manner in which PTC self-disclosed the misconduct. According to the DOJ resolution papers, PTC and its subsidiaries did not disclose all relevant facts known to the companies at the time of the initial disclosure. In fact, they did not disclose these facts until the department independently uncovered them and brought them to PTC's attention. Thus, the PTC resolution sends a strong message that incomplete or piecemeal self-disclosures are insufficient to obtain a declination. In other words, DOJ is saying that if you are coming in, you must be all-in.

Facts

This case involved PTC Inc. (formerly Parametric Technology Corporation), a Massachusetts-based technology company, whose shares are traded on the NASDAQ Global Select Market, and two of its wholly owned Chinese subsidiaries, Parametric Technology (Shanghai) Software Co. Ltd. and Parametric Technology (Hong Kong) Limited (collectively, PTC China). According to the statement of facts accompanying the DOJ resolution papers, PTC China agreed to provide travel to employees of Chinese state-owned entities (SOEs) in order to obtain and retain contracts with their employers. The travel typically began with a short, ostensibly bona fide training session at PTC's headquarters in Massachusetts but then continued on to lengthier, recreational visits to popular tourist destinations in other parts of the United States. PTC China funded these trips by inflating subcontracting and commission payments made to its local "business partners," third parties that helped PTC China identify, pursue, and execute business opportunities with Chinese SOEs.

All told, PTC China, through its business partners, paid at least $1.1 million to fund at least 24 trips that included a "recreational component" for over 100 Chinese SOE employees. The DOJ specifically described three of these trips, which involved recreational travel to New York, Las Vegas, San Diego, Atlanta, Los Angeles and Honolulu, and were associated with over $13 million in contracts between PTC and Chinese SOEs. Notably, the fact that this travel occurred in the United States appears to have been the basis for the DOJ's claim of jurisdiction over PTC China, under the FCPA's territorial jurisdiction provision, 15 U.S.C. § 78dd-3(a).[2] In addition to the improper travel, PTC China sales staff provided over $250,000 in improper gifts and entertainment directly to Chinese SOE employees, at least in part to obtain or retain business for and on behalf of PTC.[3]

On Feb. 16, 2016, the SEC and DOJ announced parallel resolutions with PTC and PTC China, respectively, with $28 million in combined penalties, disgorgement and prejudgment interest. Specifically, PTC agreed to pay $11.858 million in disgorgement and $1.764 million in prejudgment interest to settle SEC's charges, while its two Chinese subsidiaries agreed to pay a $14.54 million monetary penalty pursuant to their nonprosecution agreement with the DOJ. Interestingly, DOJ described this penalty as being "15% off the bottom of the Sentencing Guidelines fine range for [PTC China's] cooperation," even though the NPA — like other NPAs — contains no sentencing guidelines calculation.

In a related action, the SEC announced its first deferred prosecution agreement with an individual in an FCPA case, a former PTC-China employee named Yu Kai Yuan.[4] According to the SEC, Yu provided "significant cooperation" during the course of the investigation, and FCPA charges against Yu will be deferred for three years as a result.

Why This One?

Given the DOJ's recent history of deferring to an SEC remedy in cases that seem relatively similar to this one, why did DOJ decide to pursue a parallel resolution in the PTC case? The key appears to be DOJ's conclusion that PTC failed to make a complete disclosure when it self-reported the misconduct to DOJ in 2011. According to DOJ, PTC's Chinese subsidiaries:

did not receive voluntary disclosure credit because, although the Companies, through their parent corporation PTC Inc., reported to the Office in 2011 certain misconduct identified through a then-ongoing internal investigation, they did not voluntarily disclose relevant facts known to PTC Inc. at the time of the initial disclosure until the Office uncovered salient facts regarding the Companies' responsibility for the improper travel and entertainment expenditures at issue independently and brought them to the Companies' attention, after which the Companies disclosed information that they had learned as part of an earlier internal investigation.

At least in this case, a company's limited self-disclosure appears to have been the key difference between a DOJ declination and an NPA. The deficiencies in PTC China's initial disclosure also appear to have cost PTC China some cooperation credit, as the DOJ noted that the companies "did not receive full cooperation credit" for the same reasons. Nevertheless, PTC China was entitled to partial cooperation credit because, "by the conclusion of the investigation," they had disclosed all relevant facts, "including information about individuals involved in the FCPA misconduct."

The PTC resolution is consistent with recent policy statements made by senior DOJ leadership about self-disclosure and cooperation. In a November 2015 speech regarding the Criminal Division's FCPA enforcement program, AAG Caldwell stressed that, in order "to be eligible for the maximum mitigation credit in an FCPA case [a company] must do three things: (1) voluntarily self-disclose, (2) fully cooperate and (3) timely and appropriately remediate. When a company voluntarily self-discloses, fully cooperates and remediates, it is eligible for a full range of consideration with respect to both charging and penalty determinations." [5] Applying this rubric, PTC China did not receive full mitigation credit — which otherwise may have included a declination in favor of the SEC resolution — because it failed to fully satisfy the first two mitigating factors.

The DOJ's decision to award PTC China less than full cooperation credit is also consistent with the "Yates memo," a policy memo announced by Deputy Attorney General Sally Quillian Yates in September 2015 that sets forth six "key steps" designed to better hold individuals accountable for corporate wrongdoing. According to the Yates memo's first "key step," "[i]n order for a company to receive any consideration for cooperation under the Principles of Federal Prosecution of Business Organizations, the company must completely disclose to the Department all relevant facts about individual misconduct." The memo continues:

Once a company meets the threshold requirement of providing all relevant facts with respect to individuals, it will be eligible for consideration for cooperation credit. The extent of that cooperation credit will depend on all the various factors that have traditionally applied in making this assessment (e.g., the timeliness of the cooperation, the diligence, thoroughness, and speed of the internal investigation, the proactive nature of the cooperation, etc.).

Under this rubric, PTC China passed the "threshold test" and was thus eligible for cooperation credit because it provided "all relevant facts known to them, including information about individuals involved in the FCPA misconduct," but it was not entitled to the full extent of cooperation credit because the facts were provided late and only after the DOJ independently discovered them.

Takeaways

The DOJ is "pressure testing" internal investigations.

The PTC China resolution demonstrates that the DOJ is making good on recent promises to "pressure test a company's internal investigation with the facts we gather on our own." This message underscores that a company should not self-disclose misconduct to DOJ unless it is prepared to fully disclose all facts related to that misconduct. However, because it can be seen as raising the stakes of self-disclosure, especially given that the resolution does not indicate whether DOJ viewed the failure to disclose certain facts as intentional or inadvertent, it remains to be seen what effect the PTC China resolution will have on companies' willingness to self-disclose misconduct in the first place.

The DOJ is attempting to provide additional detail on the value of self-reporting and cooperation — but, in doing so, it is raising additional, unanswered questions.

The PTC China resolution also demonstrates that the DOJ is trying to make good on recent statements that "we are working on becoming increasingly transparent" in explaining the reasoning behind criminal FCPA enforcement decisions. In particular, the PTC China resolution provides a relatively clear message that a self-disclosure must be complete to be fully rewarded and that the DOJ is attempting to implement the Yates memo's "threshold" test for gaining cooperation credit.

But the PTC China resolution raises a host of additional, unanswered questions, including, among other things, why an NPA (with two subsidiaries) was appropriate, what penalty reduction should be expected for full cooperation credit, and how exactly remediation factored into the resolution. Under the circumstances described in the resolution papers, an NPA here does not seem beyond the pale, but the PTC China resolution is not a complete exposition of the DOJ's thought process. Given the competing policy objectives DOJ faces — balancing greater transparency against the protection of reputational interests of uncharged parties, confidential business information, and ongoing investigations — no statement of reasons will likely ever be complete.

Foreign subsidiaries may be exposed to FCPA territorial jurisdiction when they visit the home office.

Companies with foreign subsidiaries should pay close attention to DOJ's use of the FCPA's territorial jurisdiction to capture conduct by a foreign subsidiary in the United States.

The continuing risk posed by third parties.

Finally, as with approximately 90 percent of FCPA resolutions, the improper payments at issue in the PTC China resolution were made possible by third-party intermediaries. That is not always the case in gift, travel and entertainment cases, where those benefits are often provided directly to foreign officials by the company. But this case nevertheless shows a familiar pattern of a subsidiary inflating payments to third-party business partners in order to create a slush fund used for improper purposes — activities that may be hard to detect at headquarters.

—By James M. Koukios and Lauren A. Navarro, Morrison & Foerster LLP

James Koukios is a partner in Morrison & Foerster's Washington, D.C., office. He previously served as the senior deputy chief of the Fraud Section in the Criminal Division of the U.S. Department of Justice and was an assistant chief in the FCPA Unit from 2012 to 2014.

Lauren Navarro is an associate in the firm's Washington office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] For more discussion of this interview, see point 2 of our Top Ten International Anti-Corruption Developments for October 2015.

[2] DOJ did not allege that PTC China conspired with, aided and abetted, or acted as the agent of PTC in violating the anti-bribery provision applicable to issuers, 15 U.S.C. § 78dd-1. SEC, on the other hand, alleged a violation of 15 U.S.C. § 78dd-1, as well as violations of the FCPA's accounting provisions, 15 U.S.C. § 78m, based on the fact that PTC exercised "substantial control" over PTC China by, among other things, "creating functional reporting lines, approving PTC China's key decisions, and setting PTC China's business and financial goals." SEC alleged that PTC entered into contracts directly with SOEs as a result of the bribes paid, and under applicable agency principles, PTC China and its employees acted as agents of PTC.

[3] According to the SEC resolution, this included small electronics (cell phones, iPods, and GPS systems), gift cards, wine, and clothing costing between $50 and $600 each.

[4] SEC announced its first ever DPA with an individual in any case in 2013, explaining that its use was intended to "encourage individuals and companies to provide the SEC with forthcoming information about misconduct and assist with a subsequent investigation. In return, the SEC refrains from prosecuting cooperators for their own violations if they comply with certain undertakings."

[5] Under the Federal Principles of Prosecution of Business Organizations, DOJ prosecutors are required to consider ten factors in determining whether to bring charges, and what types, against a corporate defendant. These include, among other things, the nature and seriousness of the offense, the pervasiveness of wrongdoing within the corporation, the corporation's history of similar misconduct, the existence and effectiveness of the corporation's pre-existing compliance program, the collateral consequences of prosecuting the corporation, the adequacy of non-criminal remedies, and the adequacy of the prosecution of individuals for the misconduct. The three factors highlighted by AAG Caldwell—self-disclosure, cooperation, and remediation—are "mitigating" in the sense that they come into play, at least in theory, only after DOJ has concluded that a corporation has committed an actionable offense. They then serve to "mitigate" the penalty that the company would otherwise receive. The mitigation can come in many forms, including, but not limited to, a reduced financial penalty, a less severe form of resolution (such as a declination, non-prosecution agreement, or deferred prosecution agreement instead of a guilty plea), or a resolution with a subsidiary rather than the parent company.
