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Excessive Power for Junior Employees and Lavish Trips for Foreign Officials Lead to $28 Million PTC Settlement

By Nicole Di Schino

PTC Inc., a Massachusetts-based software company, will pay more than $28 million to settle parallel civil and criminal FCPA violations. PTC joins FLIR and SciClone in the ranks of companies settling anti-corruption cases involving outlandish hospitality. Two of PTC's China-based subsidiaries provided nearly $1.5 million of improper travel, gifts and entertainment to Chinese government officials, including trips to the U.S. consisting of little business and extensive sightseeing adventures. On PTC's dime, government officials visited Honolulu, San Diego, New York and Las Vegas and enjoyed guided tours, golfing and other leisure activities.

In a civil settlement with the SEC, PTC agreed to pay close to $11.86 million in disgorgement and over $1.76 million in prejudgment interest. Additionally, two of the company's subsidiaries entered into a non-prosecution agreement with the DOJ, agreeing to pay a $14.54 million penalty.

The SEC also announced its first DPA with an individual in an FCPA case – agreeing to defer prosecution against Yu Kai Yuan, a former employee of a PTC subsidiary, because of the significant cooperation he provided during the SEC investigation.

The True Value of Self-Disclosure

Although the DOJ and SEC have long extolled the benefits of voluntary disclosure and cooperation, recent comments by government officials indicate that the enforcement agencies will be pushing for even more self-reporting by companies and that the most favorable FCPA outcomes will not be available to companies that do not make full self-disclosures.

In a speech last November, SEC Division of Enforcement Director Andrew J. Ceresney, said, for the first time, that voluntary reporting would be a prerequisite for eligibility for a DPA or NPA with the SEC. He warned, however, that self-reporting is not sufficient, a company must also demonstrate "self-policing," "significant" cooperation and remediation. In remarks at the same event, Leslie R. Caldwell, Assistant Attorney General of the DOJ Criminal Division, said that, from a DOJ perspective, self-reporting is not required but is strongly recommended. See "*Ceresney and Caldwell Remarks Highlight New SEC Self-Reporting Policy, Cooperation, Remediation and Transparency*" (Dec. 2, 2015).

While neither Caldwell nor Ceresney specifically mentioned the effect of self-disclosure on obtaining a declination, the PTC matter demonstrates that it is highly unlikely a company would receive such a positive outcome without one. The settlement "underscores the importance of full disclosure, and the perils that can befall if companies do not disclose all facts relevant to the alleged misconduct," said Edward Kang, a partner at Alston & Bird. Bingna Guo, partner in the Beijing office of O'Melveny & Myers, agreed, explaining that "the PTC settlement shows that incomplete or partial self-disclosures are not enough to obtain a declination."

Although PTC did approach the government about its compliance failures, according to the settlement papers, it did not disclose all of the facts relevant to the alleged misconduct until the DOJ uncovered issues relating to improper travel and entertainment and brought them to PTC's attention. As a result of this failure, the DOJ did not give the company voluntary disclosure credit.

"Despite the fact that the PTC subsidiaries had provided DOJ all the facts known to them by the end of the investigation, what was problematic was PTC's

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failure to independently disclose these facts earlier," Kang explained. "This shortcoming may have cost PTC a complete declination in this case. Companies that choose to self-disclose must therefore be prepared to lay all of their cards on the table to the government."

In fact, the DOJ has declined to prosecute companies in similar circumstances that have made full and complete voluntary disclosures. Samuel Williamson, a partner in Quinn Emanuel's Hong Kong office, handled a similar issue on behalf of a client that received a declination. That decision, he believes, was based on the fact that the company made a voluntary disclosure and also because there was a lower level of misconduct involved.

While each case is clearly fact-specific, the contrast between Williamson's matter and the PTC case is instructive. "In our case, the company did make a voluntary disclosure and the senior management of the company was shocked by what had happened and was very angry about it," Williamson said. "It was very clear in tone-at-the-top-type communications from senior management to the rest of the company that this behavior was not to be tolerated, that they were making a voluntary disclosure and would make similar disclosures if this ever happened again."

He continued, "That really sent a strong message, both to other employees and to DOJ, that the company made that kind of commitment. I'm not sure a company has to make that kind of a commitment to get a declination in an individual case, but it does have to show that it has taken strong steps to remedy the conduct and reduce the risk of it happening again in the future."

The PTC settlement also highlights a dilemma that many companies find themselves in when investigating potential corruption violations, said Ron Cheng, partner in the Los Angeles and Hong Kong offices of O'Melveny & Myers. A company may "prefer to report at the completion of its investigation, for fear that early disclosure of what it knows at the outset of its investigation may be deemed inadequate because of other facts that the regulators later assert the company knew about," he observed. However, "on the other hand, the regulators often require early disclosure to obtain full voluntary cooperation credit."

See also "*When Should a Company Voluntarily Disclose an FCPA Investigation?*" (Feb. 19, 2014).

Treatment of Individuals in the Post-Yates Era

The SEC's deferred prosecution agreement with Yuan, the first such agreement with an individual in an FCPA matter, is consistent with the government's recent messaging about a more aggressive approach towards individuals, Williamson said, and is a "harbinger of what's to come." Although the recent Yates memo on individual prosecutions applies only to the DOJ and not to other agencies, Kang believes that this case demonstrates that the SEC is also turning its attention towards individual accountability, while at the same time encouraging cooperation through use of a DPA. See "*How Will the Yates Memo Change DOJ Enforcement? (Part One of Two)*" (Sep. 23, 2015); *Part Two* (Oct. 7, 2015).

"Interestingly, apart from identifying Yuan and his role as a sales executive at PTC subsidiaries in China, the DPA makes no reference to his specific conduct," observed Timothy Belevetz, a partner and Holland & Knight. Thus it remains unclear what the basis for any possible enforcement against Yuan would be.

Sensitive Activities and Junior Employees: A Dangerous Combination

The involvement of more senior employees in the management of the company's third parties could have prevented at least some of PTC's compliance failures, in Williamson's opinion. Many of PTC's third-party partners were lobbyists or others providing "influence services," such as arranging meetings and seminars with employees of state-owned enterprises. The SEC order describes paying for such influence services as inherently risky and chastises PTC for failing to undertake a "sufficient review of the business capabilities or ethics programs of these business partners."

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Despite that risk, PTC appears to have given significant discretion to more junior employees, Williamson said. If a company is going to be engaging in relationships with lobbyists or other influence service providers, "people who are aware of the company's global legal obligations need to be involved in supervising [those] high-risk relationships and making sure they are being handled consistent with the company's legal obligations," he cautioned. "The problem that companies often get into is that pushing discretion down to the lowest levels can, in some instances, make business sense," he said, but doing so increases the compliance risk because local employees are less likely to be familiar with U.S. legal risk and "that's where they get in trouble."

Four Additional Steps to Limit Risks When Using Influence Services

A company can take several other specific measures to mitigate corruption risk when partnering with third parties that arrange contact with employees of state-owned enterprises.

1) Carefully Select Partners

Selecting lobbyists or others to provide influence services requires compliance measures beyond typical third-party due diligence. "A company can use these types of vendors, but they have to be thoroughly vetted in advance," Belevetz said. "A company needs to understand the qualifications, capabilities, reputation and history of any third-party vendor, including lobbyists," he explained.

These types of advisors in particular need to be selected because they have "real expertise," Williamson warned. "The company needs to be supervising the people that it hires in these areas and needs to be making sure that the person the company is hiring is being hired because of the expertise they have and not because of some inappropriate relationship with the government," he explained. "There are people here that have expertise in dealing with the Chinese government, just like there are people in the U.S. that have expertise in dealing with the U.S. government, that can be very useful to multinationals doing business here."

See "*Sample Questions to Ask Third Parties When Initiating Anti-Corruption Due Diligence*" (Oct. 9, 2013).

2) Define the Terms of the Relationship

Once a partner is selected, "the terms of the relationship, including payment terms, should be laid out clearly in a written contract," Belevetz said. Kang added that the agreement should also reflect "payment commensurate to work being performed, representations and warranties regarding anti-corruption compliance and certification of compliance with the law." Additionally, "the lobbyist should provide a certification up front and annually that it is in compliance with anti-corruption laws and related company policy and agree to ongoing monitoring," he said.

See our series on third-party contracts, "*A Guide to Anti-Corruption Representations in Third-Party Contracts: Nine Clauses to Include (Part One of Two)*" (Jun. 25, 2014); "*Clauses for High-Risk Situations and Enforcement Strategies (Part Two)*" (Jul. 9, 2014).

3) Assign Responsibility for a Relationship to a Senior Employee

"For each specific third-party relationship, particularly ones in riskier areas like this," Williamson recommended that "a company dedicate one specific employee who is responsible for overseeing that relationship." That individual would then be responsible for "ensuring that it is handled in a manner that is consistent with the company's global legal obligations," he said. "That person should be trained and understand that he or she is responsible for this, so that on a day-to-day basis that person is interacting with those third parties to make sure that they are doing things correctly."

4) Conduct Continuous Monitoring

While the relationship is ongoing, companies should regularly monitor the third party. Launching a "missile" of a compliance program into the atmosphere and then forgetting about it is "absolutely the wrong approach" for these kinds of relationships, Williamson said. "The company should be monitoring who its third party

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is meeting with, what the goals of those meetings are, what the specific deliverables are, whether there are certain policy papers that they should be preparing, whether there is analysis that they should be doing and what milestones there are to ensure that this is being done correctly," he explained. Additionally, a company should have "internal controls sufficient to accurately and completely track payments to the vendor," Kang advised.

"At the end of the day, the company needs to be able to give a short and clear answer to the question: what are we paying this third party to do? That should be something that includes specific activities and not just, 'We are hiring them because they can influence decision makers,'" Williamson said.

See "*Managing FCPA and Other Risks After Onboarding a Third Party*" (Nov. 14, 2012).

Using Variable, Success-Based Fees to Disguise Troubling T&E

One of the reasons that PTC employees were able to provide inappropriate travel and entertainment to foreign officials is that sales staff had "wide discretion" when setting fee arrangements with the company's business partners. Partners were paid a "success fee," from as low as 15% to as high as 30% of the contract price if a deal was successful. Because of their discretion over the fee associated with a deal, PTC employees "were able include the costs of the overseas travel as part of a business partner's fees without raising suspicion," the SEC order alleges. The business partner would then use part of its success fee to provide overseas travel.

Using success fees "can be risky," Belevetz said, because "the SEC and DOJ view them as red flags that increase the likelihood that a bribe has been paid," as was indeed the case here. If a company believes using a success fee may be appropriate, it "must understand and articulate the specific reasons for that financial arrangement," Kang advised. "To that end, companies should consider whether there is a need for the use of such arrangements and whether market standards justify using such arrangements," he said. To help them make these determinations, "companies can require the prospective third party to conduct a questionnaire tailored to the specific circumstances of the company, which can be used to identify the reasons behind using a success fee arrangement, as well as to demonstrate good faith due diligence and robust and effective internal controls."

Kang added that "if a company determines that a success fee arrangement is necessary, it should properly document the amount being paid to third parties and the reasons for such an arrangement." As with other high-risk arrangements, Williamson reiterated that if a company decides to use success fees "supervision structures really need to be in place."

SEC Focuses on the Lack of Risk-Based Policies

PTC's ineffective compliance policies, as well as its failure to perform periodic comprehensive risk assessments, contributed to its internal controls failures, the SEC alleged. The company's code of ethics and anti-corruption policies were vague, the government said, and not "risk based to China." See "*Conducting Effective Anti-Corruption Risk Assessments: An Interview With David Simon, Partner at Foley & Lardner*" (Nov. 20, 2013); and "*An Interview With Kevin Bennett, Managing Director, Forensic and Valuation Services, at Grant Thornton*" (Dec. 4, 2013).

While there is no formalized requirement that a company have different policies for every location where it operates, "localized policies are becoming more common to account for possible parent liability for foreign subsidiary misconduct, especially in high-risk countries," Kang observed. "In China, for example, given the prevalence of SOEs, companies should consider tailoring and localizing their policies and procedures to account for these circumstances," he said. "For companies with operations on this scale, localized polices should strongly be considered," Cheng agreed. "This is not the first time that regulators have identified the need for localized policies and dedicated compliance personnel for the region."

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"A company should at the very least, translate its policies and training presentations on FCPA compliance issues into local languages and ensure adequate understanding," Kang advised.

"In general, policies should be drafted in clear and unambiguous language that can be understood by all readers," Kang said. In addition to not being China-specific, PTC's policies failed because they were too ambiguous. For example, the SEC order notes that "employees should use 'good taste' and consider the 'customary business standards in the community' when providing business entertainment." Such phrases "leave too much discretion for employees," Kang said. Instead, a company "needs to provide an overview of how it will structure its relationships with foreign representatives and business partners," he continued. "It should explicitly state the limited circumstances in which payments may be made to foreign officials, including when 'grease payments' may be made or when limited gifts can be given. It must clearly identify the consequences to employees and agents if they violate the law or company policy. Most importantly, written policies should be followed up with periodic training, certifications, monitoring and audits."

See "*Six Steps to Revitalize the Company Compliance Code*" (Aug. 20, 2014).

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