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DOJ and SEC Pressure Test Accuracy of Self-Reporting and Cooperation in PTC FCPA Settlement

Executive Summary

On February 16, 2016, the Securities and Exchange Commission and the Department of Justice announced settled parallel enforcement and criminal actions against Massachusetts-based technology company PTC, Inc. and its two wholly-owned Chinese subsidiaries (“PTC-China”), alleging violations of the anti-bribery provisions and internal accounting controls and books and records provisions of the Foreign Corrupt Practices Act.¹ The SEC also announced its first ever deferred prosecution agreement (“DPA”)² in an FCPA case with Yu Kai Yuan, a former employee of PTC-China, “as a result of significant cooperation [he] provided during the SEC’s investigation.”³ The SEC and DOJ separately alleged that between at least 2006 and 2011, PTC-China provided improper travel, gifts and entertainment totaling nearly \$1.5 million directly and through third-party agents to Chinese government officials employed at Chinese state-owned entities (“SOEs”) to obtain or retain business from them. As a result, PTC gained approximately \$11.8 million in profits from sales contracts with SOEs whose officials received the improper payments. The improper payments were falsely recorded in PTC’s books and records as legitimate commissions or business expenses.⁴

¹ See *Tech Company Bribed Chinese Officials*, SEC Press Release 2016-29 (Feb. 16, 2016), available at <https://www.sec.gov/news/pressrelease/2016-29.html>; *PTC Inc. Subsidiaries Agree to Pay More Than \$14 Million to Resolve Foreign Bribery Charges*, DOJ Press Release 16-179 (Feb. 16, 2016), available at <http://www.justice.gov/opa/pr/ptc-inc-subsidiaries-agree-pay-more-14-million-resolve-foreign-bribery-charges>.

² Under a DPA, prosecutors typically file charges and reach an agreement with the defendant to defer prosecution for a defined period of time in exchange for some combination of payment of a monetary penalty, an admission of wrongdoing, the implementation of remedial measures, and/or an agreement to cooperate fully and truthfully. The government promises to dismiss the charges at the end of the agreement’s term if the defendant satisfies the obligations the defendant undertakes pursuant to the DPA.

³ *Tech Company Bribed Chinese Officials*, SEC Press Release 2016-29 (Feb. 16, 2016), available at <https://www.sec.gov/news/pressrelease/2016-29.html>; see also Yu Kai Yuan Deferred Prosecution Agreement (“DPA”), available at <https://www.sec.gov/litigation/admin/2016/34-77145-dpa.pdf>.

⁴ See *In the Matter of PTC Inc.*, Exchange Act Release No. 77145 (Feb. 16, 2016), available at <https://www.sec.gov/litigation/admin/2016/34-77145.pdf>; PTC Non-Prosecution Agreement (“NPA”), available at <http://www.justice.gov/opa/file/824911/download>.

Under the SEC's cease and desist order, PTC agreed to pay disgorgement of \$11.9 million and prejudgment interest of \$1.8 million.⁵ In addition, under a non-prosecution agreement ("NPA")⁶ entered into with the DOJ, PTC-China agreed to pay a \$14.5 million fine and to provide annual reports during the NPA's three-year term regarding the status of its remediation efforts and the implementation of various enhanced compliance measures.⁷ In total, PTC agreed to pay a combined approximately \$28 million in penalty and disgorgement to resolve these matters.

This resolution underscores what senior DOJ and SEC officials have been emphasizing publicly for some time – that their enforcement efforts are focused on corporations and individuals alike – and is consistent with recent statements by senior leadership at those agencies about their scrutiny of corporate self-disclosure and cooperation.⁸ Specifically, PTC-China's resolutions with the DOJ and SEC demonstrate that U.S. regulators are increasingly testing the thoroughness and veracity of a company's self-disclosures by, among other things, pursuing cooperation from witnesses who are uniquely positioned to provide relevant information about corporate misconduct. Accordingly, a company confronted with evidence of corruption-related malfeasance must not only conduct a thorough internal review, but should also carefully consider whether it is prepared to fully disclose all facts related to that misconduct to the authorities.

Factual Allegations

According to the order, the DPA and the NPA, from at least 2006 through 2011, PTC-China provided non-business travel, primarily sightseeing and tourist activities, as well as other improper gifts and entertainment, to Chinese government officials who were employed by Chinese SOEs. These benefits,

⁵ Release No. 77145 at 11.

⁶ Under an NPA, prosecutors agree not to criminally prosecute a defendant for any crimes relating to certain conduct that the defendant had fully disclosed to the authorities prior to entering into such an agreement. As with a DPA, prosecutors agree not to bring charges in exchange for some combination of conditions, typically including the defendant's ongoing cooperation for a certain period of time.

⁷ NPA at 3-4, C-1.

⁸ See DOJ Memorandum Authored by Deputy Attorney General Sally Quillian Yates on Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) at 2-5, *available at* <http://www.justice.gov/dag/file/769036/download> (noting that "in order to qualify for any cooperation credit, corporations must provide to the [DOJ] all relevant facts relating to the individuals responsible for the misconduct"); Remarks of Assistant Attorney General Leslie R. Caldwell at American Conference Institute's 32nd Annual International Conference on Foreign Corrupt Practices Act (Nov. 17, 2015), *available at* <http://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-delivers-remarks-american-conference> ("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.").

totaling nearly \$1.5 million in value, were provided in connection with certain sales contracts at least in part to obtain or retain business with these SOEs. PTC, which designs, manufactures and sells product management software, earned approximately \$11.85 million in profits from these contracts. Yu Kai Yuan, a Chinese citizen who resides in Shanghai, China, was employed by PTC-China as a sales executive during this time period.⁹

For sales to Chinese SOEs, PTC-China routinely hired well-connected Chinese “business partners” to find deals and to provide information technology and other services, which PTC-China subcontracted to these business partners. In exchange, these business partners were paid a “success fee” or commission that varied substantially from deal to deal, typically from 15% to 30% of the sales contract, as senior PTC-China staff had wide discretion in negotiating and setting the fee arrangements for each particular deal.¹⁰

During contract negotiations, SOE employees and officers often requested that PTC-China provide them with overseas “training,” which primarily involved sightseeing visits. The trips typically included a single day visit to PTC’s corporate headquarters in Massachusetts or another PTC facility, followed or preceded by additional days of sightseeing visits that lacked any business purpose. PTC-China, the business partners and the SOEs would settle on a travel budget and increase the SOE’s contract price by the amount of the anticipated costs. Although PTC-China sales staff itemized these expenses in the initial contract documents that were approved by senior PTC-China staff, once approved, PTC-China employees removed the line items from the final contract documents that were signed by PTC and the SOEs, and disguised these costs as expenses related to the business partners’ success fees. Between 2006 and 2007, the overall costs of such trips exceeded \$1.1 million.¹¹

In addition, between 2009 and 2011, PTC-China sales staff provided more than \$250,000 in improper entertainment and gifts, including small electronics such as cell phones and iPods, gift cards, wine and clothing. These items were given directly to Chinese government officials in part to obtain or retain SOE business.¹²

⁹ Release No. 77145 at 2; DPA at 3; NPA at A-2, A-3, A-6.

¹⁰ Release No. 77145 at 3-4; DPA at 3-4; NPA at A-3, A-4.

¹¹ Release No. 77145 at 4-7; DPA at 5; NPA at A-3, A-4, A-5.

¹² Release No. 77145 at 7; NPA at A-6.

The SEC's DPA with Yu Kai Yuan

The SEC's DPA with Yuan resolved allegations that, while an employee of PTC-China, he caused PTC-China to violate the internal accounting controls and books and records provisions of the FCPA.¹³ In accepting the DPA, Yuan acknowledged full responsibility for his conduct and agreed to cooperate with the SEC, including by providing requested documents and other materials, submitting to interviews and other inquiries, and testifying at trial, if requested. The DPA's term is three years, effective February 16, 2016.¹⁴

The DOJ's NPA with PTC-China

On February 16, 2016, the DOJ entered into an NPA with PTC-China to resolve allegations that it violated the FCPA's anti-bribery and internal accounting controls and books and records provisions. PTC-China agreed to pay a \$14.5 million criminal fine, and to implement a compliance and ethics program designed to prevent and detect violations of the FCPA and other applicable anti-corruption laws. It also agreed to report annually to the DOJ about remediation and implementation of these compliance measures, and to cooperate with the DOJ in any ongoing investigations of PTC-China and its officers and employees relating to violations of the FCPA as well as other domestic and foreign law enforcement and regulatory authorities or agencies. The NPA is for a term of three years, effective February 16, 2016.¹⁵

The Justice Department noted that PTC-China did not receive voluntary disclosure credit or full cooperation credit because it "did not voluntarily disclose relevant facts known to [it] at the time of the initial disclosure [of certain misconduct identified through an internal investigation] until [the DOJ] uncovered salient facts . . . independently and brought them to [PTC-China's] attention." By the conclusion of the DOJ's investigation, however, PTC-China had provided the DOJ with all relevant facts known to it, "including information about individuals involved in the FCPA misconduct."¹⁶

¹³ Although the SEC has had various cooperation policies in place for years, it was not until November 2012 that the SEC first entered into a DPA with an individual, and appears to have done so on only one other occasion thereafter prior to now. *See SEC Announces First Deferred Prosecution Agreement with Individual*, SEC Press Release 2013-241 (Nov. 12, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540345373>. *See also SEC Charges Three RMBS Traders with Defrauding Investors*, SEC Press Release 2015-181 (Sept. 8, 2015), available at <http://www.sec.gov/news/pressrelease/2015-181.html>.

¹⁴ *See* DPA at 1-2.

¹⁵ *See* NPA at 1-4.

¹⁶ *See* NPA at 1; *see also* Release No. 77145 at 10. The DOJ has issued several Opinion Releases that offer some guidance with respect to gifts, travel and entertainment under the FCPA, which likely informed its consideration of the facts and circumstances presented by this matter. *See, e.g.*, Dep't of Justice Criminal Div. Opinion Release 12-02 (Oct. 18, 2012); Dep't of

Observations

The PTC-China matter is the latest in a string of recent actions brought by U.S. regulators under the FCPA that have involved bribes paid to Chinese government officials and representatives of SOEs in the form of gifts, travel and entertainment.¹⁷ The case also illustrates that the DOJ and SEC are making good on recent promises to “pressure test a company’s internal investigation with the facts [those agencies] gather on [their] own.”¹⁸ Moreover, the SEC’s ability to secure the cooperation of a foreign national in this matter demonstrates the significant tool that alternative dispositions such as NPAs and DPAs with individuals represent in assisting the government in its own investigations.

In the case of PTC-China, Yu Kai Yuan signed his DPA with the SEC several months before the regulators’ settlement with the company was announced, suggesting that the SEC’s decision to enter into a DPA with that individual could very well have been in recognition of information he could provide against the company that might not otherwise be obtained or, at the very least, obtained with ease. Accordingly, the SEC’s decision to enter into a DPA with an individual defendant in this matter suggests that companies should be prepared for their employees, and former employees, to cooperate with regulators and provide information about corruption, internal controls and record-keeping issues, and the company’s internal investigation must be able to withstand such pressure testing by government authorities. In determining whether or not to self-report misconduct, the company should assess the degree of confidence it has that its internal investigation can withstand such scrutiny.

Justice Criminal Div. Opinion Release 07-02 (Sept. 11, 2007); Dep’t of Justice Criminal Div. Opinion Release 07-01 (July 24, 2007).

¹⁷ See *SciClone Pharmaceuticals Settles FCPA Action Over China Business Practices*, Paul, Weiss, Rifkind, Wharton & Garrison LLP – Anti-Corruption & FCPA Practice Group Client Alert (Feb. 16, 2016), available at <http://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/sciclone-pharmaceuticals-settles-fcpa-action-over-china-business-practices.aspx?id=21483>; *SEC FCPA Action Against Bristol-Myers Squibb Highlights Importance of Addressing Red Flags and Compliance Gaps*, Paul, Weiss, Rifkind, Wharton & Garrison LLP – Anti-Corruption & FCPA Practice Group Client Alert (Oct. 8, 2015), available at <http://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/sec-fcpa-action-against-bristol-myers-squibb-highlights-importance-of-addressing-red-flags-and-compliance-gaps.aspx?id=21012>; *SEC Extends Application of FCPA Accounting Provisions in BHP Billiton Enforcement Action*, Paul, Weiss, Rifkind, Wharton & Garrison LLP – Anti-Corruption & FCPA Practice Group Client Alert (May 28, 2015), available at <http://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/sec-extends-application-of-fcpa-accounting-provisions-in-bhp-billiton-enforcement-action.aspx?id=20053>.

¹⁸ Remarks of Assistant Attorney General Leslie R. Caldwell at New York University Law School’s Program on Corporate Compliance and Enforcement (Apr. 17, 2015), available at <http://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-delivers-remarks-new-york-university-law>.

As a related matter, a company must appreciate the risks that come with self-disclosing misconduct while not fully disclosing all relevant facts. The deficiencies in PTC-China's initial disclosure appear to have cost PTC-China some cooperation credit, although it ultimately received partial credit for having disclosed all relevant facts by the conclusion of the authorities' investigations. The PTC-China resolution thus reconfirms the message that self-disclosure must be complete to be fully rewarded.

Finally, the PTC-China resolution is consistent with recent policy statements by senior DOJ leadership about self-disclosure and cooperation. As Assistant Attorney General Leslie R. Caldwell recently stressed, 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."¹⁹ These resolutions underscore the importance of conducting a thorough internal review when compliance issues come to the company's attention. The scope of any internal investigation should be periodically reviewed based on the facts and circumstances developed during the course of that review. As this case demonstrates, a company's limited self-disclosure can be a substantial factor in determining whether a matter gets resolved by an outright declination, a DPA or an NPA.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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¹⁹ Remarks of Assistant Attorney General Leslie R. Caldwell at American Conference Institute's 32nd Annual International Conference on Foreign Corrupt Practices Act (Nov. 17, 2015), available at <http://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-delivers-remarks-american-conference>.