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Panasonic Reaches Global Settlement with DOJ and SEC Over FCPA Violations

On April 29, 2018, the U.S. Department of Justice entered into a deferred prosecution agreement with California-based Panasonic Avionics Corp. ("PAC"), a wholly-owned subsidiary of Panasonic Corporation ("Panasonic"), in connection with a one-count criminal information charging PAC with violations of the internal accounting controls and books and records provisions of the Foreign Corrupt Practices Act. To resolve the matter, PAC, which manufactures in-flight entertainment systems, agreed to pay a criminal penalty of approximately $137 million and accepted the imposition of an independent compliance monitor for two years.[1] In a related proceeding concerning the same conduct, Panasonic consented to a cease-and-desist order with the U.S. Securities and Exchange Commission and agreed to pay approximately $143 million in disgorgement, including prejudgment interest, to settle allegations of violations of the anti-bribery, books-and-records, and internal accounting controls provisions of the FCPA and the anti-fraud provisions of the securities laws.[2] The combined amount of the U.S. criminal and regulatory penalties to be paid exceeds $280 million.

PAC has admitted that, between 2007 and 2013, employees, including senior executives, retained as consultants a foreign official, who was involved in negotiating a lucrative contract amendment with PAC on behalf of a state-owned Middle Eastern airline, and a consultant for a domestic airline, who obtained confidential, non-public business information for PAC. Payments to these individuals were falsely recorded as legitimate consulting services in Panasonic's books and records. PAC also used sales agents that did not meet the company's diligence requirements and recognized revenue prematurely.[3]

Factual Allegations

According to the DPA and the SEC's cease-and-desist order, PAC provided a consulting position to a government official who assisted PAC in obtaining business from a state-owned airline in the Middle East. In 2004, the airline and PAC entered into a supply agreement, which was ultimately valued at over $1 billion, for PAC to provide in-flight entertainment products for certain planes in the airline's fleet. The

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1 *See* Deferred Prosecution Agreement ("DPA") (ECF 2-1), *U.S.* v. *Panasonic Avionics Corp.*, No. 18-CR-00118 (D.D.C. Apr. 30, 2018), *available at* https://www.justice.gov/opa/press-release/file/1058466/download.

2 *See* In the Matter of Panasonic Corporation ("SEC Order"), Exchange Act Release No. 83128 (Apr. 30, 2018), *available at* https://www.sec.gov/litigation/admin/2018/34-83128.pdf.

3 DPA at A-5 to A-6.

government official was the primary point of contact for contract negotiations with PAC. In 2006, the government official and an agent of PAC began negotiating an amendment to the 2004 contract worth nearly $360 million, and in 2007 they negotiated a second amendment worth an additional $353 million in business for PAC. During the course of negotiations, a PAC sales representative obtained clients for the government official's private consulting firm and, with the knowledge of PAC executives, offered the government official a position as a PAC consultant at an annual salary of $200,000 plus travel expenses upon his retirement from the airline. Using funds in an "Office of the President" budget, a PAC executive arranged for the government official to be paid through an unrelated third-party vendor that prepared product manuals for PAC. Over six years, PAC paid the government official $875,000. The SEC characterized Panasonic's dealings with the government official as bribery. The government official provided minimal work to PAC, which earned over $92 million in profits attributable to twelve programs at the state-owned airline.[4]

Separately, from 2007 through at least January 2014, PAC also failed to maintain adequate internal accounting controls. Specifically, the government found that PAC's internal accounting controls were not reasonably designed to ensure that funds paid to purported consultants were used in accordance with the law and were properly recorded in PAC's, and ultimately Panasonic's, books and records. These control deficiencies related to payments made to consultants from PAC's Office of the President budget. Notably, between 2007 and 2013, PAC paid a former employee now working as a consultant to one of its largest American airline customers $825,000 in exchange for non-public information regarding the American airline. The former employee also evaluated bids submitted by PAC and other vendors for contracts to be awarded by the airline customer. Between 2008 and 2013, PAC earned over $22 million in profits attributable to business from the American airline customer on three different programs in which the former employee had some involvement.

PAC senior executives continued to approve payments to the government official and former employee, as well as other consultants, despite reports from PAC's internal audit department warning of the "critical risk" associated with continuing to pay multiple consultants in the absence of any deliverables provided to PAC. The report noted that PAC's procurement department was "not involved in hiring these consultants," that the "visibility of the contract process needs to be enhanced," and that the consultant payments "should be carefully reviewed in light of FCPA regulation."[5]

PAC also used sales agents that did not meet the company's diligence requirements. Beginning in at least 1999 and continuing until at least 2016, PAC utilized the services of several third-party agents in Asia to obtain and manage contracts with state-owned airlines. In or around 2009, PAC required that new and existing sales agents obtain certification from a third-party risk-management service. Although PAC

4 SEC Order at 4–5; DPA A-9 to A-13.

5 DPA at A-8.

terminated its formal relationship with certain sales agents that did not pass the service's anti-bribery certification, PAC employees secretly rehired the non-certified agents as sub-agents of another agent. Between 2008 and 2013, PAC paid the agent over $7 million for the benefit of the non-certified sub-agents. These payments were improperly accounted for as commission payments to the certified agent.[6]

Through the improper retention of consultants paid out of the Office of the President budget, the payment of such consultants through a third-party vendor, and the concealment of the continued use of sales agents in Asia, PAC caused Panasonic to falsify its books, records and accounts. Further, PAC executives implicated in the unlawful scheme falsely certified PAC's financial statements given to Panasonic for Sarbanes-Oxley consolidation purposes.

In addition, PAC prematurely recognized revenue from the state-owned Middle Eastern airline, causing Panasonic to overstate its pre-tax income by at least $38.5 million, or 9 percent, and its net income by at least $22.4 million, or 16 percent, for the first quarter of 2012.

PAC disclosed the possible violations only after the SEC requested documents from Panasonic, several years after PAC and Panasonic first became aware of the allegations of bribery through a whistleblower complaint and civil lawsuit. PAC took steps to investigate the complaint but chose not to report it voluntarily to the DOJ or the SEC. Accordingly, in connection with the DPA, PAC did not receive voluntary disclosure credit. The DOJ did credit PAC's cooperation with the Fraud Section's investigation and PAC's significant, but untimely, remedial measures, for which it received an aggregate discount of 20 percent off of the bottom of the otherwise-applicable U.S. Sentencing Guidelines fine range.[7]

Implications of the Resolution

This is the second DPA entered into this year by the DOJ for FCPA violations and the third FCPA enforcement action for the SEC this year.[8] Much like the SEC's action against Elbit Imaging Ltd., which was announced in March, the action against PAC and Panasonic is another instance of an enforcement

6 *Id.* at A-16 to A-18.

7 *Id.* at 3–4.

8 Paul, Weiss, *FCPA Enforcement and Anti-Corruption Developments: Q1 2018* (Apr. 13, 2018), *available at* https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/fcpa-enforcement-and-anti-corruption-developments-q1-2018?id=26253.

action relating to payments to third-party vendors or consultants with little or no evidence that the purported services were legitimate and/or actually provided.[9]

There are several observations and takeaways arising out of this enforcement action:

- The SEC counted among the things of value the assistance PAC provided the foreign government official in obtaining clients for the government official's private consulting firm. This is a further indication of the broad interpretation the Commission ascribes to "anything of value." It may be prudent for companies to take a similarly broad view when reviewing agreements or other arrangements with third parties for compliance purposes and to document carefully and comprehensively the work being performed by third parties.

- The DOJ and the SEC apparently found PAC's retention of a former employee in exchange for non-public information and its employment of sales agents in violation of the company's due diligence policy to be further evidence of PAC's books and records violation and the inadequacy of its internal controls. In light of this finding, companies may want to review closely their diligence practices to ensure they meet appropriate risk-based standards. They might also ensure that their hiring processes are consistent with internal due-diligence policies by, among other things, auditing samples of agent engagements to ensure they are signed in accordance with the company's policies. But, as Hui Chen, the DOJ's former compliance counsel, recently explained, third-party due diligence alone may be insufficient. Risks may also arise during a company's ongoing working relationship with its employees and vendors.[10] Following up to ensure that policies are implemented adequately is a critical part of an effective compliance program.

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9 Paul, Weiss, *Elbit Imaging Settles with SEC in First FCPA Resolution of 2018* (Mar. 15, 2018), *available at* https://www.paulweiss.com/practices/litigation/anti-corruption-fcpa/publications/elbit-imaging-settles-with-sec-in-first-fcpa-resolution-of-2018?id=26116.

10 Hui Chen, *Seven Signs of Ineffective Compliance Programs*, Corporate Accountability Report (Mar. 22, 2018), *available at* https://huichenethics.files.wordpress.com/2018/03/seven-signs-of-ineffective-compliance-programs.pdf.

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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