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WHITE-COLLAR CRIME

Expert Analysis

Corporations and Risks of Mandatory Disclosures to the Government

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One of the axioms of white-collar practice today is that companies, especially public companies, do not litigate against criminal and civil enforcement authorities, except in rare circumstances. The threshold for establishing corporate liability is too low, and the costs and risks of vigorously challenging the government are too high. The typical result of these conditions is a negotiation with the government over the charges included in a settlement, whether admissions will be required and, if so, their nature and scope, and how much the company will have to pay the authorities.

In this article, we discuss two trends that may make the already constrained position of companies even more difficult in terms of increased exposure to liability and reduced opportunities to mitigate the terms of settlement. First, companies face expanded self-reporting obligations, requiring them affirmatively to disclose to the government information about possible corporate misconduct. Such obligations come on top of the disclosures required of public companies by federal securities laws and self-reporting required of broker-dealers under FINRA rules. In effect, companies coming under federal regulation, and that is a large number of companies, may increasingly have to become whistleblowers against themselves.

Second, compounding the dangers of self-reporting, the Department of Justice has shown increased interest in using the false statement statute, 18 U.S.C. §1001, and related theories of liability, against companies. In a number of recent, high-profile cases, the government has brought charges against companies based, in significant part, on allegedly false or misleading statements to government authorities. So, not only must companies increasingly report considerable information to the government; they must face prosecution for getting the information wrong.

While neither self-reporting nor prosecution for false statements, in themselves, are objectionable, the process of enforcement can lead to injustice. Particularly in white-collar matters, companies and criminal authorities often disagree sharply over whether a statement is false and over such mental state issues as knowledge, intent and willfulness. It is one thing if these disagreements could be litigated before a neutral fact-finder; it is another if, as noted, companies often have to concede matters that are subject to genuine doubt.

Obligation to Self-Report

Issues relating to corporate self-reporting are not new.[1] What has changed is that, increasingly, these issues are arising not as a matter of prudence—whether a company should make the judgment to report misconduct—but as a matter of obligation. In 2008, the executive branch adopted a mandatory disclosure rule that requires government contractors and subcontractors to disclose to the government any "credible evidence" of specified criminal violations, a violation of the civil False Claims Act or a "significant overpayment" in connection with a government contract or subcontract.[2]

The number and complexity of self-reporting obligations have only increased since 2008, particularly for government contractors. The Federal Awardee Performance Integrity Information System, created in 2010, is a clearinghouse for contractor responsibility information and requires contractors to disclose to government agencies criminal convictions, civil liability and administrative proceedings related to the performance of

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government contracts.[3] Prospective government contractors must also disclose labor violations from the past three years before they can obtain a contract.[4]

The Department of Defense requires defense contractors to implement processes to detect wrongdoing and, if misconduct is found, to report it to the department. For instance, defense contractors are required to monitor and report the possession and use of counterfeit materials in the DoD supply chain,[5] and implement security measures to monitor and report any actual or potential breach of stated cybersecurity rules that could impact classified, controlled or technical information.[6] In most instances, contractors must certify their disclosures subject to the penalties of perjury.

Self-reporting requirements are not limited to companies that regularly contract with the federal government. Financial institutions that received government funds from the Troubled Asset Relief Program (TARP) are required to send regular reports to the Treasury Department which discuss the institution's implementation and compliance with TARP requirements. These reports must be accompanied by a certification from a senior officer attesting that, to the best of his or her knowledge, such reports are accurate.[7]

Companies in industries that directly affect public health and safety have additional obligations of self-reporting. Food manufacturers regulated by the Food and Drug Administration are obligated to report when there is a "reasonable probability that the use of, or exposure to, an article of food will cause serious adverse health consequences or death to humans or animals."[8] Drug and medical device manufacturers are also obliged to regularly file reports regarding the safety of marketed products,[9] as well as comply with reporting obligations intended to create transparency about the financial relationship between companies and the physicians who prescribe and use their products.[10]

Under self-reporting rules, companies are often required to disclose information before misconduct has been proven, such as when any "credible evidence" arises. According to comments accompanying the mandatory disclosure rule, the "credible evidence" standard is considered higher than the "reasonable grounds to believe" standard, and is intended to allow the contractor an opportunity to conduct a preliminary examination of the evidence to determine its credibility before making a decision about whether to disclose to the government.[11]

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Despite this elaboration on the disclosure standard, companies will have to wrestle with questions as to whether enough evidence of wrongdoing exists to warrant disclosure, how much time it will take to gather the necessary information, and the risk of disclosing, or not disclosing, if initial indications of wrongdoing turn out to lack merit.[12]

Government's Response

One of the principal risks of increasing disclosure obligations is the reporting of information that turns out to be incorrect. Of course, if false information is provided to the government intentionally, civil and even criminal liability understandably arises. For example, government agencies, such as the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), have investigated and referred matters involving false statements for criminal and civil enforcement.[13]

In many cases, genuine questions will arise as to whether the information reported to the government is false and, if so, whether it was given intentionally and with knowledge of its falsity. In a common situation, companies, like individuals, may find themselves required to give information to government authorities when the facts are not fully known and may still be unfolding, as in rapidly changing financial markets or an accident that affects the environment.[14] In such cases, companies and law enforcement authorities might genuinely disagree both as to the accuracy of the information and state of mind when the statements were made.

An examination of some recent prosecutions illustrates the risks and ramifications to companies of making disclosures that government authorities later determine to be false.

'United States v. Toyota Motor Corp.' In the spring of 2014, Toyota Motor Corp. entered into a deferred prosecution agreement (DPA) with the U.S. Attorney's Office for the Southern District of New York following a criminal investigation into how the company disclosed driver complaints of unintended acceleration in its vehicles. The government alleged that the company made misleading statements to U.S. regulators and consumers about the cause of the problem.

In 2009, Toyota issued a limited safety recall of eight of its U.S. models to address "floor mat entrapment," which caused accelerators to get stuck at nearly full or fully depressed levels. The company told the public that the recall "addressed the root

cause" of the unintended acceleration problem in these eight models.

However, according to the Statement of Facts agreed to by Toyota in the DPA, Toyota's statements in connection with the 2009 recall were false in two respects. First, internal tests conducted at the company revealed that other models not included in the original recall were also susceptible to "floor mat entrapment." Second, Toyota also failed to disclose that it had discovered another cause of unintended acceleration, referred to as the "sticky pedal" problem. When the company issued additional safety recalls in early 2010 to address the sticky pedal problem and cover vehicles not included in the original recall, Toyota provided "the American public, its U.S. regulator, and Congress an inaccurate timeline of events that made it appear as if Toyota had acted to remedy the sticky pedal problem within approximately 90 days of discovering it."[15]

Toyota consented to the filing of a one-count information charging Toyota with wire fraud under Section 1341 of Title 18. Toyota further agreed to pay a $1.2 billion penalty in the form of civil forfeiture.[16] The settlement received court approval in July 2014.

'SEC v. Reserve Management Co.'

While the case against Reserve Management Co. was civil, not criminal, and involved statements to investors, it raises the issue of charging a company with false statements made at a time when precise information may be hard, even impossible, to ascertain.

In 2009, the Securities and Exchange Commission filed securities fraud charges against the mutual fund, Reserve Primary Fund, and its owners, father-and-son team Bruce Bent and Bruce Bent II, for false statements allegedly made by the company preceding the fund's collapse during the 2008 financial crisis. The collapse was reportedly a "significant turning point" in the crisis because money market funds had long been perceived as a nearly risk-free alternative to a bank account.[17]

In November 2012, the fund's parent company, Reserve Management Company, was found by a jury to have made fraudulent statements withholding from investors, trustees and rating agencies key information about the fund's vulnerability during the crisis, especially after Lehman Brothers—a company in which the fund had substantial holdings—filed for bankruptcy.[18] The jury rejected the SEC's fraud claims against the Bents individually, finding only that the son had acted negligently.

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In awarding the SEC a $750,000 penalty in the case—a small fraction of the $130 million sought by the agency—District Judge Paul Gardephe noted that the "defendants confronted conditions not seen since the Great Depression. The markets were in chaos and the ramifications of Lehman's bankruptcy were not initially well understood, even by sophisticated fund managers and Government regulators."[19]

Conclusion

In our present regulatory environment, companies find themselves reporting information to the government with increased frequency and in greater quantities. In some cases, companies may struggle with whether the events actually warrant disclosure. If disclosure is made, companies may worry about whether the information is accurate. Recent history suggests that such worry is justified. If the government disagrees with the accuracy of the information, a company may find itself, particularly in a high-profile case, with limited ability to contest the government's allegations and defend its good faith.

1. See Elkan Abramowitz and Jonathan Sack, "Dilemma of Self-Reporting: The FCPA Experience," NYLJ (Jan. 8, 2014).
2. 73 Fed. Reg. 67064 (Nov. 12. 2008).
3. Duncan Hunter National Defense Authorization Act of 2009, P.L. 110-417, §872.
4. Executive Order, "Fair Pay and Safe Workplaces," The White House (July 31, 2014).
5. Department of Defense, "Instruction: DOD Counterfeit Prevention Policy No. 4140.67" (2013).
6. See Intelligence Authorization Act for Fiscal Year 2014, P.L. 113-126, §325; National Defense Authorization Act for Fiscal Year 2013, P.L. 112-239, §941.
7. SIGTARP Report, "Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance," SIGTARP-10-007 at Table 1 (June 29, 2010).
8. See Overview of Requirements for a Food Business, U.S. Food and Drug Administration website (www.fda.gov/Food/ResourcesForYou/Industry/ucm322302.htm#report).
9. See, e.g., 21 C.F.R. s. 310.305 (report requirements for prescription drugs marketed for human use without approved new drug applications); 21 C.F.R. s. 314.80 (reporting requirements for drugs approved with new drug applications).
10. Physician Payments Sunshine Act as set forth in Section 301 of Patient Protection and Affordable Care Act, Pub. L. 111-148.
11. 73 Fed. Reg. at 67073 (Nov. 12, 2008).
12. Dietrick Knauth, "Self-Reporting is All the Rage in Recent Contractor Regs," Law360.com (Aug. 25, 2014).
13. See, e.g., SIGTARP, Quarterly Report to Congress at p. 18 (Jan. 29, 2014),
14. Many of the issues discussed in this article were present in *United States v. BP Exploration & Production*, the criminal case that arose from the 2010 Deepwater Horizon oil spill. The authors' firm represented an individual in the investigation. See Guilty Plea Agreement, *United States v. BP Exploration & Production*, (E.D. La.) (available at http://www.justice.gov/iso/opa/resources/433201211151436139900027.pdf).
15. Case Statement, "United States v. Toyota Corporation," U.S. Attorney's Office for the Southern District of New York (available at http://www.justice.gov/usao/nys/vw_cases/toyota.html).
16. Toyota Motor Corporation Deferred Prosecution Agreement (March 19, 2014) (available at http://www.justice.gov/iso/opa/resources/6832014319942407372 5.pdf).
17. See Nathaniel Popper and Jessica Silver-Greenberg, "Money-Market Pioneer and Son Cleared of Fraud," The New York Times (Nov. 12, 2012).
18. Complaint, *SEC v. Reserve Management Co*., 09CV4346 (S.D.N.Y. May 5, 2009).
19. Nate Raymond and Jonathan Stempel, "US Judge Awards $750,000 in Case of Money Fraud That 'Broke Buck,'" Reuters (Sept. 30, 2013).