Bloomberg Law®

bloombergbna.com

In a two-part series, Dechert LLP's Vince Cohen and Deborah Kemi Martin discuss the implications of *Lagos v. United States* on the course of a corporate investigation. The first part of the series focuses on lower courts' responses to corporations seeking restitution following *Lagos*. The second part will address the questions a corporation must answer during its initial decision-making about the structure of an investigation.

INSIGHT: Corporate Investigations in the Age of *Lagos*: Maximizing Restitution Without Losing Cooperation Credit—Part I

BY VINCE COHEN AND DEBORAH KEMI MARTIN

As Deputy Attorney General Rod Rosenstein has pointed out on many occasions, a corporate culture of compliance results in many benefits. Indeed, the Department of Justice maintains that strong compliance programs ''attract investors and partners,'' act as a ''preventative medicine'' against bad actors, and ''free[] [government] investigators and attorneys to focus on corporate criminals who post the most dangerous and imminent threats to the American people—terrorists, drug traffickers, transnational cyber criminals.'' Moreover, ''[w]hen a company creates and fosters a culture of compliance, it creates value.''

But what of the value *consumed* by the investigations essential to corporate compliance?

That's a question worth $145 million to FIFA and other corporate victims seeking restitution right now in proceedings before the U.S. District for the Eastern District of New York.

FIFA and similarly positioned soccer associations seek repayment from the soccer officials who spearheaded a staggering bribery scandal. These associations are not alone in incurring enormous expenses to investigate violations. As corporate disclosures have long shown, corporate investigations are typically lengthy and costly. For instance, in July 2017, WalMart, Inc. disclosed it had spent $7 million on ongoing inquiries and investigations for FCPA matters alone in Q2 FY18 and $20 million YTD. And such spending is neither a new development nor unique to multinational corporations. In 2014, Nordion, Inc., a Canadian company much smaller than Walmart, reported that it spent $11.8 million in FY2013 and $9.8 million in FY2012 on an internal investigation of ''potential improper payments'' and ''financial irregularities'' in its dealings with a foreign supplier and other third parties.''

Once upon a time, the rule in most Circuits was that Section 3663A(b)(4) of the Mandatory Victims Restitution Act of 1996 (the ''MVRA''), 18 U.S.C. § 3663A, requires defendants to reimburse corporate victims for amounts these corporations spend to investigate potential violations that later result in a conviction. But, if the Supreme Court's recent guidance in its May 29, 2018 *Lagos v. United States* decision—and the lower courts' decisions since then—are any indication, corporate victims who dutifully obey the DOJ's dictates may be left empty handed going forward. *Lagos*, a 7–0 decision, reversed near-unanimous lower-court precedent. More than ever, companies seeking to navigate this tangled and contradictory web of case law and agency policy will need experienced outside counsel.

1. Restitution Under the MVRA Was the Norm Pre-*Lagos*

In *Lagos*, General Electric Capital Corporation (''GECC'') conducted an internal investigation after finding out that petitioner, Lagos, had defrauded GECC of tens of millions of dollars. Using a company he controlled, Lagos had generated false invoices for services

not performed in order to mislead GECC about the value of his company's accounts receivable. Lagos had then borrowed money from GECC using the false invoices as collateral. After investigating the scheme, GECC shared the information it had discovered with the government during the government's subsequent investigation. Lagos and his co-conspirators were then indicted in the U.S. District Court for the Southern District of Texas and pleaded guilty to multiple counts of wire fraud and conspiracy. After Lagos's conviction, the government requested that the district court order him to pay restitution to GECC under Section 3663A(b)(4) of the MVRA. And the district court duly so ordered this restitution. Among the costs Lagos was ordered to reimburse GECC was the $5 million cost of its internal investigation, which corresponded to legal, accounting, and consulting fees.

Although decisions since its enactment have narrowed the statute's scope, the MVRA has long been a powerful tool for victims. The MVRA requires courts to order defendants convicted of enumerated offenses, including those ''committed by fraud or deceit,'' to ''make restitution to the victim of the offense[.]'' 18 U.S.C. § 3663A(a)(1), (c)(1). The statute defines victims broadly as those ''directly and proximately harmed as a result of the commission of an offense for which restitution may be ordered'' and those ''directly harmed by the defendant's criminal conduct in the course of [a] scheme, conspiracy, or pattern.'' In what has become known as the MVRA's ''other expenses'' clause, Section 3663A(b)(4) of the statute requires an order of restitution to ''reimburse the victim for lost income and necessary child care, transportation, and other expenses incurred during participation in the investigation or prosecution of the offense or attendance at proceedings related to the offense.''

In practice, the MVRA streamlines the process of restitution. First, it mandates sentencing courts to order defendants convicted of certain federal offenses to make restitution as part of the sentence. Thus, victims obtain restitution as a matter of right, without costly litigation or additional proceedings beyond sentencing. Second, victims' costs are further reduced because the government, itself, seeks this restitution on behalf of victims.

Before *Lagos*, six federal courts of appeals had concluded that Section 3663(A)(b)(4) required courts to order defendants to pay companies expenses incurred in investigating the defendants' offenses. These Courts of Appeals included the Second (*United States v. Amato*, 540 F. 3d 153, 159–163 (2d Cir. 2008)), Fifth (*United States v. Phillips*, 477 F.3d 215 (5th Cir. 2007)), Sixth (*United States v. Elson*, 577 F. 3d 713, 726–729 (6th Cir. 2009)), Seventh (*United States v. Hosking*, 567 F. 3d 329, 331–332 (7th Cir. 2009)), Eighth (*United States v. Stennis-Williams*, 557 F. 3d 927, 930 (8th Cir. 2009)), and Ninth (*United States v. Gordon*, 393 F. 3d 1044, 1056–1057 (9th Cir. 2004)) Circuits, which encompass the United States' most important financial and business centers. The costs these courts had routinely authorized included fees for attorneys, accountants, and forensic experts. Thus, in the majority of jurisdictions, companies enjoyed reimbursement under the MVRA for a wide array of investigation-related costs. And such restitution makes sense. It hardly seems fair for a corporation fulfilling its legal and ethical obligations to root out criminality to be left bearing the costs of investigating a wrongdoer's actions.

Until 2011, the D.C. Circuit was in the majority as well. In 2011, however, the D.C. Circuit became the sole outlier when it reversed a district court's order requiring a defendant to pay his employer the $160,000 it expended in investigating his wrongdoing. In *United States v. Papagno*, the D.C. Circuit ruled that ''participating'' in a government investigation does not include an internal investigation ''that has not been required or requested by criminal investigators or prosecutors.'' *Papagno* created the circuit split that the Supreme Court resolved in *Lagos*.

2. *Lagos* Ended Restitution of Proactive and 'Voluntary' Internal Investigations' Costs

Following Fifth Circuit precedent on Section 3663A(b)(4), the district court in *Lagos* ordered Lagos to reimburse GECC for the costs of its investigation, among other expenses. The Fifth Circuit affirmed, explaining that Lagos's ''wire fraud scheme caused GECC to employ forensic experts to secure and preserve electronic data as well as lawyers and consultants to investigate the full extent and magnitude of the fraud and to provide legal advice relating to the fraud.''

The Supreme Court reversed the Fifth Circuit in a 7–0 decision. Echoing the D.C. Circuit's opinion in *Papagno*, the Supreme Court held that the words '' 'investigation' and 'proceedings' '' within Section 3663A(b)(4) are ''limited to government investigations and criminal proceedings'' and exclude ''private investigations and civil proceedings.'' Thus, after *Lagos*, only costs incurred during ''a victim's role in a government's investigation and in the criminal proceedings that a government conducts[]'' are *per se* reimbursable under Section 3663A(b)(4).

Additionally, the Supreme Court held that Section 3663A(b)(4) ''does not cover the costs of a private investigation that the victim chooses on its own to conduct.'' In so holding, it rejected the government's argument that the fact that GECC shared information from its private investigation with the government during the government's subsequent investigation made GECC's expenses reimbursable. In rejecting this argument, the Supreme Court explained that ''during'' within the meaning of Section 3663A(b)(4) ''does not refer to expenses incurred *before* the victim's participation in the government's investigation began.'' Because GECC incurred the costs of its investigation before the government's investigation started, the Supreme Court rejected these costs as non-reimbursable ''preparticipation expenses.''

In denying GECC reimbursement of its costs incurred before the government's investigation began, the Supreme Court expressly left open the question of whether Section 3663A(b)(4) ''would cover similar expenses incurred during a private investigation that was pursued at a government's invitation or request.'' Implicit in this statement is the notion that an ''invitation or request'' from the government is distinct from the beginning of the government's investigation. The task of grappling with this and other unclear statements in *Lagos* will fall to corporate victims and the lower courts.

3. Lower Courts Applying *Lagos* Have Withheld Millions of Dollars from Corporate Victims

As the decisions of lower courts applying *Lagos* since May show, this unanimous decision is already a significant obstacle for corporate victims seeking restitution

of internal investigations' costs under the MVRA. Indeed, in the few months since *Lagos* was issued, a number of lower courts have denied companies reimbursement under the MVRA. In June 2018, within a month of *Lagos* being issued, the Eighth Circuit rendered the *United States v. Cornelsen* decision. Citing *Lagos*, the Eighth Circuit applied *Lagos* to reverse a district court's restitution order awarding a company $250,000 in accounting and attorneys' fees. Although the panel noted that ''*Lagos* appears to run contrary to our precedent[,]'' the company was still left to foot the bill arising from its investigation of its CFO's wire fraud.

In July 2018, the Eastern District of New York stayed its own order in *United States v. Razzouk* initially awarding ConEdison and its insurer just under $2 million in restitution from a former employee who accepted bribes. Characterizing *Lagos* broadly as ''[holding] that, under the MVRA, a defendant cannot be forced to reimburse a victim for expenses incurred during an internal investigation of the defendant's illegal actions,'' the court ''agree[d] with the parties that *Lagos* may affect the award of restitution to Con Edison for its investigative costs.'' In August 2018, the District of Kansas ruled in *United States v. Zhang* that the corporate victim there was entitled to only 60 percent of its $300,000 in corporate investigation expenses because ''40% of employees' time was spent on Ventria's internal investigation and 60% was spent participating in the government's investigation and prosecution.'' The court also denied Ventria reimbursement of its attorneys' fees. In *United States v. Sexton*, the corporate victim narrowly escaped *Lagos*. There, the district court did not make specific factual findings regarding the corporate investigation expenses it ordered the defendant to pay because he did not dispute the restitution amount. Thus, the Sixth Circuit was unable to determine whether the corporate victim ''accrued those fees within the limits that the Supreme Court set in *Lagos*.''

And, although restitution in the FIFA cases has yet to be resolved, initial indications regarding the $145 million in restitution there are not comforting. Indeed, in a hearing on October 4, 2018 (*U.S. v. Napout et al.*, No. 1:15-cr-00252 (E.D.N.Y.)), Judge Pamela Chen at the Eastern District of New York explained: ''I can tell you generally speaking that, after Lagos, I think there's not much support for internal investigations undertaken by the victims unless, and even this I think is still questionable, unless invited or requested to do so by the government[.]''

4. A *Lagos* Analysis Is Essential to Decision Making Regarding Corporate Investigations

In less than five months, *Lagos* has already cost companies millions in restitution, with potentially hundreds of millions more to be lost in the FIFA cases. It is readily apparent that, going forward, conducting what we term a ''Lagos analysis''—analyzing how to structure a particular corporate investigation in order to best preserve the likelihood of restitution under the MVRA—will be an essential part of decision making regarding corporate investigations. Thus, in Part II of our series on structuring corporate investigations, we explore the questions and considerations to which corporations, corporate counsel, and outside counsel must be attentive in conducting a *Lagos* analysis.

Vincent H. Cohen Jr., a partner in Dechert LLP's Washington D.C. office, is the former acting U.S. Attorney for the District of Columbia. He represents individuals and corporations in high-stakes matters, including sensitive government and internal investigations, government enforcement matters, and complex civil and criminal litigation domestically and internationally. In 2018, Chambers USA recognized Mr. Cohen as one of the District of Columbia's leading White-Collar Crime & Government Investigations lawyers and Lawdragon named him one of America's 500 Leading Lawyers.

Deborah Kemi Martin is an associate in Dechert LLP's New York office. She focuses on white collar defense, internal and government investigations, enforcement actions, anti-corruption compliance, and related complex litigation domestically and internationally. Ms. Martin clerked for Judge McKee at the U.S. Court of Appeals for the Third Circuit and Judge Sleet at the U.S. District Court for the District of Delaware. The National Bar Association, Sanctuary for Families, and The Network Journal have all recognized her for her advocacy.