Anti-Corruption Report

Lifecore Biomedical Declination Exemplifies 2023's Self-Disclosure Trend

By Lisa Schor Babin, *Anti-Corruption Report*

On November 16, the Criminal Division of the DOJ issued a Declination Letter to Lifecore Biomedical, Inc. (f/k/a Landec Corporation). The DOJ stated that it would not prosecute Lifecore for FCPA violations committed by Yucatan Foods L.P., a company it had acquired in 2018, because Lifecore had satisfied multiple factors under the Corporate Enforcement Program, the updated Corporate Enforcement and Voluntary Self-Disclosure Policy (CEP), and the Safe Harbor Policy.

DOJ officials have made numerous public statements and speeches this year, encouraging companies to voluntarily self-disclose instances of misconduct to earn applicable benefits under the DOJ's revised policies. The Lifecore declination illustrates how timely discovery, disclosure and remediation of criminal conduct at an acquired company can earn favorable treatment from the DOJ.

With DOJ enforcement policy updates as a backdrop, this article examines and draws lessons from the Lifecore declination and from two other DOJ declinations in 2023. It also offers practical advice for companies to heed the critical call for diligence in implementing effective compliance programs, with insights from Withersworldwide counsel Martin Auerbach, Steptoe & Johnson partner Iris Bennett, Hughes Hubbard & Reed partners Michael DeBernardis and Laura Perkins, Womble Bond Dickinson partner

Luke Cass, and Mololamken partner Eric Nitz.

See "Reading the Regulators: Shifts in FCPA Enforcement" (Aug. 16, 2023).

DOJ Declines Prosecution of Lifecore Biomedical

Facts in Lifecore's Bribery Case

According to the Lifecore Declination Letter, between May 2018 and August 2019, employees of Lifecore's former U.S. subsidiary, Yucatan Foods, bribed one or more Mexican government officials before and after Lifecore's acquisition of Yucatan.

Landec Corporation, through its wholly owned subsidiary, Apio, Inc., acquired Yucatan Foods, a leading processor and marketer of Mexican guacamole, in December 2018. Yucatan owned and operated a guacamole manufacturing facility in Guanajuato called Procesadora Tanok S. de R.L. de C.V (Tanok).

The Lifecore Declination Letter states that the Yucatan employees paid $14,000 in bribes to a government official through a third-party intermediary to secure a wastewater discharge permit. Tanok employees and agents also paid a third-party service provider $310,000 to prepare fraudulent manifests purporting to show the provider had delivered wastewater to a municipal water company for disposal, according to the letter.

"The use of third parties is common in these cases because it is a way for individuals involved in such conduct to channel funds out of their own company for an illicit purpose without being detected – for example, by papering it as payment to a vendor for services," Bennett explained.

"Using third parties may avoid detection not only by superiors at the company, but also by regulators," Nitz noted.

The Tanok employees knew a portion of the fee was used to bribe one or more local Mexican government officials to sign the fraudulent manifests, according to the declination letter. By creating these false documents, payments associated with needed on-site

wastewater treatment and applicable duties to the Mexican government were avoided, the letter claims.

Post-Acquisition Discovery and Investigation

During Lifecore's pre-acquisition due diligence of Yucatan and Tanok, at least one Yucatan officer tried to conceal the misconduct from Lifecore and its auditor, the declination letter alleges.

Because of the more limited information available during pre-acquisition due diligence, it is not uncommon that an issue is discovered post-acquisition, Bennett pointed out. And where there is an attempt to actually conceal information, as apparently occurred here, that would be even more true, she said.

The standard applied is not about whether Lifecore could have discovered the misconduct, but whether it could have reasonably discovered it, according to another lawyer who commented while requesting anonymity.

"Whether or not it was really concealed or could have been discovered, this case highlights the need to include compliance risks and possible violations of laws, including the FCPA, in any due diligence process for an M&A transaction," Cass clarified.

When a company is being acquired, there are often red flags that put the purchasing company on notice that anti-corruption compliance is a risk area, Nitz said.

The DOJ's Safe Harbor Policy recognizes that the information acquirors can obtain pre-acquisition may be limited, even if robust due diligence is done, and gives companies up to six months to disclose post-acquisition.

Lifecore found out about misconduct in post-acquisition integration and launched its internal investigation. In its 10-Q filed in January 2020, Lifecore disclosed that it had initiated an investigation into potential environmental and FCPA compliance matters associated with regulatory permitting at the Tanok facility in Mexico.

There probably was no other environmental matter other than the wastewater disposal issue, Auerbach stated. "Otherwise, it almost certainly would have been in the declination letter," he explained.

Factors in the Declination Decision

The DOJ declined to prosecute Lifecore based on factors set out in the Criminal Division's CEP and the Principles of Federal Prosecution of Business Organizations, Justice Manual 9-28.300. These factors included:

- Lifecore's timely and voluntary self-disclosure of misconduct, which it reported within three months of first discovering the possibility of misconduct and hours after an internal investigation confirmed that misconduct had occurred.
- Lifecore's full and proactive cooperation and its agreement to continue to cooperate with any ongoing government investigations and any future prosecutions. Lifecore made a specific condition of the sale of Yucatan and Tanok that they would continue to cooperate with the government. This was a material condition of the sale to Lifecore's successor-in-interest.
- The nature and seriousness of the offense.
- Lifecore's timely and appropriate remediation, including the termination of the Yucatan officer primarily responsible for the scheme and withholding that officer's bonus and other compensation and substantially improving its compliance program and internal controls.
- Lifecore's seeking to fully remedy the situation by agreeing to disgorge the benefits it derived from the bribery and forgery scheme.

Lifecore Disgorged Illicit Cost Savings

Lifecore earned a financial benefit of approximately $1.286 million from its illegal scheme – *i.e.*, charges that it avoided through bribery and forgery. The DOJ insisted that Lifecore disgorge $406,505 to the U.S. Treasury. This was calculated as the $1.286 million saved, minus the $879,555 in expenses it incurred with the construction of a wastewater treatment plant – an alternative going forward to disposing of the wastewater – and payment of applicable duties to the Mexican government.

DeBernardis explained that the DOJ and the SEC have long held

that bribes paid to foreign officials to avoid obligations such as taxes, fees, and legal judgments violate the FCPA in the same manner as bribes paid to directly obtain or retain business.

"In those circumstances, whether the matter is resolved through a plea agreement, DPA, NPA, or declination, it is common to see disgorgement calculated based on the expenses or obligations avoided. Companies are required to disgorge whatever benefit, whether in the form of cost savings or additional profit, they obtained through the bribery scheme," DeBernardis said.

Cost avoidance was the primary motivation, Bennett emphasized. "Illicit cost savings, as in this case, constitute a form of illicit gain for purposes of calculating disgorgement. The money spent on remediation – here, the on-site facility to deal with the wastewater issue – is credited against the amount that would otherwise need to be disgorged," she added.

Potential for SEC Enforcement

Auerbach suggested that when there is a DOJ disposition, there is usually a simultaneous announcement of an SEC disposition. "We don't see that in this case, but we know that Lifecore has significant issues with its financials and internal controls disclosed in its recent SEC filings, so it may well be that the SEC will bundle all of these issues together."

Lessons Learned From 2023 DOJ Declinations

There were three declinations in 2023, with Lifecore Biomedical, Corsa Coal and HealthSun Healthcare. In all three cases, the DOJ declined to prosecute based on a similar combination of factors. These included the nature of seriousness of the violations. They also included the fact that the company promptly and voluntarily self-disclosed, fully and proactively cooperated, agreed to continue to cooperate, and timely and appropriately remediated. Albermarle was denied declination because its self-disclosure was determined as not "reasonably prompt."

Declinations are a good way to incentivize companies to self-report, Auerbach noted. “Responsible lawyers counsel their clients about this, and if there’s an uptick in disclosures, it is likely there will be an increase in declinations.”

Auerbach said that intensified focus on enforcement will motivate companies to weigh their risk equation and police themselves to end bad conduct, knowing that they will receive favorable treatment.

Takeaways From Lifecore Biomedical’s Declination

“The DOJ wanted to make a point with this case. You do it right, and we’ll treat you well,” Auerbach said. Considering Lifecore’s current financial situation reported in its SEC filings, he believes that prosecution would have been the company’s death knell.

The Lifecore case is instructive on what the DOJ considers a timely self-report, both in the M&A context and more generally, Perkins noted. “Companies can find some comfort in that, even though Lifecore waited up to three months until after it conducted investigative steps to determine the veracity of the initial suggestion of misconduct, its self-report was still considered timely,” she said.

DeBernardis believes the Lifecore declination demonstrates the value of thorough post-acquisition integration, especially when an acquiring company could not conduct sufficient pre-acquisition diligence. Moreover, it shows the value of conducting a swift and efficient internal investigation when discovering potential misconduct, he said.

“This case also serves as a reminder that FCPA risks are present even when companies are not dealing with foreign government contracts or customers. Inspections, permits, licenses, and other regulatory obligations in foreign countries create FCPA risk regardless of the industry,” DeBernardis stated.

Many companies doing business in Mexico face U.S. enforcement risk because of the environment there and the risk of a jurisdictional nexus for U.S. authorities, Bennett suggested. Since 2016, Mexico has had quite robust laws on the books with respect to

bribery of government officials, but the investigatory and enforcement agencies have been understaffed and lacking in resources, and enforcement is notoriously weak, she added.

"This case highlights the continuing corruption risk in Mexico, a country with a poor track record of enforcing its anti-corruption laws and long-standing issues – including, as reflected in this case, at the local level when it comes to things like licenses and permits," Bennett concluded.

Third-party intermediary use, particularly in this kind of environment, should be closely scrutinized, Cass said. "The use of third-party agents or intermediaries, and especially the conditioning of a business relationship on the use of third parties or intermediaries, is a red flag and often a first indicator of an FCPA issue. Lifecore did the right thing and DOJ came to a reasonable result," he noted.

Questions From Corsa Coal's Declination

According to the March 8, 2023, Corsa Declination Letter, from 2016 into 2020, Corsa Coal Corp. employees and overseas agents funneled bribes to government officials who controlled Al-Nasr Company for Coke and Chemicals, a state-owned steel business, including to the chairman of Al-Nasr. Corsa secured $143 million in coal contracts from Al-Nasr and earned roughly $32.7 million in profits. However, disgorging the $32.7 million in illicit profits would have left Corsa financially unviable, so after an independent forensic review, prosecutors decided on $1.2 million in disgorgement, which Corsa agreed to pay.

Corsa met the standards of the CEP: voluntary disclosure, cooperation and remediation, which included termination of a culpable sales representative and improvement of its internal controls. Based on the revised CEP, when aggravating circumstances are present, which includes "significant profit" to the company, a company is only eligible for a declination if the company voluntarily discloses "immediately," provides "extraordinary cooperation" to the DOJ and had a pre-existing effective compliance program at the time of the misconduct.

See "Assistant AG Polite Discusses Declinations in Cases With Ag-

gravating Circumstances and Revised ECCP" (Apr. 12, 2023).

Warnings From HealthSun Health Plans' Declination

According to the October 25, 2023, HealthSun Declination Letter, in a scheme spanning from 2015 to 2020, HealthSun Health Plans submitted false risk-adjustment data relating to beneficiary diagnoses for chronic ailments to the Centers for Medicare & Medicaid Services (CMS). Enrollees in HealthSun's Medicare Advantage (MA) Plan did not actually have such chronic ailments. Coders used physicians' login credentials to alter tens of thousands of patient electronic medical records to add fraudulent diagnoses.

The DOJ said that CMS made approximately $53 million in overpayments to HealthSun, increasing HealthSun's profits and the individuals' compensation. In providing the declination, the DOJ reinforced its view that the conduct was driven by a small group of individuals, not by corporate edict. Epstein Becker Green suggested that with an aging U.S. population, the increasing popularity of MA and the corresponding massive federal spend going to MA Plans, federal law enforcement in the MA space may be the next wave of complex health care fraud activity.

Albermarle Denied Declination Under the Revised CEP

In January 2018, Albemarle voluntarily disclosed to the DOJ misconduct relating to four separate geographies but did not receive full credit for the disclosure. The disclosure was not "reasonably prompt," as defined in the CEP and the U.S. Sentencing Guidelines (USSG), according to the Non-Prosecution Agreement (NPA).

The company learned of allegations regarding possible misconduct in Vietnam approximately 16 months before disclosing. After an internal investigation, the company gathered evidence demonstrating the potential misconduct at least nine months prior to the disclosure.

The DOJ effectively penalized the company by requiring an NPA with a substantial monetary penalty and three-year reporting period, instead of a declination with disgorgement. Nonetheless, the

case demonstrated the importance of timely disclosure and cooperation, remediation to include preventing or pulling back compensation when possible, and auditing and monitoring.

See "Albemarle Resolutions Bring First Application of DOJ's Compensation Incentives and Clawbacks Pilot Program" (Nov. 8, 2023).

Updates to FCPA Enforcement Policies Encourage Companies to Self-Disclose

2016: The Pilot Program

The Pilot Program, launched by the DOJ's Fraud Section in April 2016, created a temporary system to encourage companies to voluntarily disclose an FCPA violation, cooperate fully with the resulting government investigation, remediate the misconduct, and disgorge any tainted profits in exchange for a reduction of up to 50-percent off the bottom of the USSG fine range. The DOJ would also *consider* a declination of prosecution and would generally not require the imposition of a compliance monitor if these conditions were met.

Under the Pilot Program, companies failing to voluntarily disclose FCPA violations could not receive more than a 25-percent discount off the bottom of the USSG fine range, regardless of their level of cooperation or remediation.

2017: Corporate Enforcement Policy

On November 29, 2017, Deputy AG Rod Rosenstein announced the adoption of the FCPA Corporate Enforcement Policy, which attempted to further encourage voluntary disclosure of FCPA violations by companies, removing its "pilot" status by incorporating the general framework for credit for voluntary disclosure of FCPA violations into the U.S. Attorney's Manual.

The new Corporate Enforcement Policy created a presumption that the DOJ would decline to bring enforcement actions when companies self-disclose, fully cooperate, remediate misconduct and disgorge any ill-gotten profits if there were no aggravating

circumstances. Aggravating circumstances included involvement by senior management in the misconduct, significant profit to the company from the misconduct, pervasiveness of the misconduct within the company and "criminal recidivism."

Non-recidivist companies that did not receive a declination, but satisfied the terms of the Corporate Enforcement Policy, would receive a 50-percent reduction off the low end of the USSG fine range. This is a meaningful contrast to the more discretionary "may accord up to" language from the Pilot Program.

January 2023: Revisions to the Corporate Enforcement Policy

On January 17, 2023, the DOJ rolled out its updated CEP, which offered new and concrete incentives to companies to promote immediate self-disclosure, meaningful cooperation and timely remediation. These revisions fell into three categories.

1. Providing transparency on when a company can receive a declination even when there are "aggravating factors."
2. Increasing the maximum potential fine reduction where a company voluntarily self-discloses even where criminal prosecution is still warranted.
3. Increasing the maximum potential fine reduction where a company does not voluntarily self-disclose but provides "extraordinary cooperation."

The then Assistant AG, Kenneth A. Polite, Jr., announced that companies can earn a declination if they can demonstrate that they "earn it by following our policies." This could be achieved, he said, through voluntary self-disclosure made immediately upon the company becoming aware of the allegation of misconduct; having an effective compliance program and system of internal accounting controls at the time of the misconduct and disclosure; and extraordinary cooperation and remediation.

See "Corporate Enforcement Policy Revisions: A More Amenable DOJ Looks to Negotiate" (Feb. 1, 2023).

February 2023: USAO Voluntary Self-Disclosure Policy

In February 2023, the DOJ announced the latest iteration of U.S. Attorney's Office (USAO) voluntary self-disclosure policy (VSD), outlining new incentives for companies to report corporate misconduct.

Under the policy, companies that become aware of misconduct before it is known by the DOJ may disclose that misconduct to a USAO, which, in turn, would not seek a guilty plea where the company voluntarily self-disclosed, fully cooperated and remediated the criminal conduct – so long as no aggravating factors were present.

While the CEP and VSD are governed by different entities, the two policies are largely the same, though the CEP provides a presumption of declination for full compliance, while the VSD policy only provides a presumption of a not-guilty plea.

See "DOJ Incentivizes Self-Disclosure Once More With Guidance for U.S. Attorneys' Offices" (Mar. 15, 2023).

March 2023: Pilot Program on Compensation Incentives and Clawbacks

In March 2023, the DOJ released updated guidance in the Evaluation of Corporate Compliance Programs (ECCP) and launched a Pilot Program Regarding Compensation Incentives and Clawbacks, both of which emphasized the importance of tying employee compensation systems to compliance, including through compensation clawbacks.

This Pilot Program was meant to encourage companies who do not already factor compliance into compensation to retool their programs and get ahead of the curve, said Deputy AG Lisa O. Monaco when she announced the program. The program requires companies to implement compliance-related criteria into their compensation and bonus systems when entering into criminal resolutions. It also provides for possible fine reductions if corporations claw back compensation from culpable employees and those who had supervisory authority over them or who were "willfully blind" to the misconduct.

See "DOJ's Pilot Program on Clawbacks to Foster Individual Accountability Poses Challenges for Companies" (Mar. 29, 2023).

October 2023: M&A Safe Harbor Policy

On October 4, 2023, Monaco announced a new DOJ safe harbor policy for voluntary self-disclosures made in connection with mergers and acquisitions, placing an enhanced premium on timely compliance-related risk-based pre- and post-acquisition due diligence and integration. This policy creates a declination presumption for acquiring companies that identify and voluntarily disclose misconduct within six months of closing and fully remediate the misconduct within one year of closing.

"Good companies – those that invest in strong compliance programs – will not be penalized for lawfully acquiring companies when they do their due diligence and discover and self-disclose misconduct," said Monaco. She added that the goal of the policy is to make clear that the DOJ does not want to discourage companies with effective compliance programs from lawfully acquiring businesses with ineffective compliance programs and a history of misconduct.

In other words, compliance must have a prominent seat at the deal table if an acquiring company wishes to effectively de-risk a transaction. Monaco cautioned that if a company does not perform effective due diligence or self-disclose misconduct at an acquired entity, it will be subject to full successor liability for that misconduct under the law.

See "Safe Harbor Policy Seeks to Encourage Self-Reporting of Issues in M&A Transactions" (Oct. 11, 2023).