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ALERT

Anti-Corruption / International Risk

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PTC Inc. Reaches $28M Settlement with DOJ and SEC to Resolve China FCPA Allegations

I. Introduction

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On February 16, 2016, two Chinese subsidiaries of Massachusetts-based software company PTC Inc. ("PTC") entered into a non-prosecution agreement with the U.S. Department of Justice ("DOJ") and will pay $14.54 million to resolve allegations that the companies violated the Foreign Corrupt Practices Act ("FCPA"). PTC also reached a separate civil settlement with the U.S. Securities and Exchange Commission ("SEC") whereby PTC will pay disgorgement of $11.8 million and prejudgment interest of $1.7 million.

The government concluded that two PTC subsidiaries – Parametic Technology (Shanghai) Software Co. Limited and Parametic Technology (Hong Kong) Limited (collectively "PTC China") – provided recreational travel and other improper payments to employees of Chinese state-owned enterprises (SOEs) in an effort to generate business. As part of its investigation, the SEC also announced its first deferred prosecution agreement with an individual in an FCPA case. FCPA charges will be deferred for three years against Yu Kai Yuan, a former employee at PTC China, as a result of Yuan's significant cooperation with the SEC.

II. Settlement Details

According to the DOJ and SEC settlements, PTC China routinely relied on local third parties – called "business partners" – to help PTC China find prospective customers, assist PTC China in sales to Chinese SOEs and provide additional services to PTC China's customers, including information technology services. During contract negotiations with SOEs, SOE employees, in conjunction with a business partner, often requested that PTC China provide them with overseas "training," which involved primarily tourist and sightseeing visits to the United States. The trips typically consisted of one day of business activities at PTC's Massachusetts facility followed or preceded by additional days of recreation that lacked any business purpose. Typical PTC-paid travel destinations included New York, Las Vegas, San Diego, Los Angeles and Honolulu, and involved guided tours, golfing and other leisure activities. The SOE employees taking these trips were often signatories on purchase agreements with PTC.

From 2006 to 2011, PTC China paid more than $1.1 million to fund at least 10 trips for SOE employees that included significant non-business travel. The costs of these trips were disguised in PTC's books and records as legitimate commissions paid to business partners or as ordinary subcontracting payments, without any indication they were primarily for sightseeing and other non-business-related activities.

In addition to these recreational trips, the SEC concluded that from 2009 to 2011, PTC China sales staff provided SOE employees with at least $274,313 in gifts and entertainment. The value of the gifts and entertainment generally ranged from $50 to $600, and often included small electronics, gift cards, wine and clothing. By providing these gifts, which were improperly recorded as legitimate business expenditures, PTC China violated PTC's corporate governance and internal control procedures.

The settlement agreements described widespread failures in PTC's internal accounting controls and oversight of PTC China. Notably, during 2006, 2008 and 2010, PTC investigated compliance issues at PTC China, including possible corruption involving its business partners. PTC nevertheless failed to identify and stop payments to Chinese officials by PTC China and failed to undertake effective remedial efforts. PTC also failed to undertake periodic risk assessments of PTC China and to ensure that its internal accounting controls were tailored to address PTC China's ongoing dealings with SOEs. According to the SEC, PTC's Code of Ethics and Anti-Bribery policies were vague and did not account for specific corruption risks associated with doing business in China. PTC also lacked independent compliance staff or an internal audit function to review and test its internal accounting controls processes and, if appropriate, take remedial actions. The SEC concluded that these organizational failings prevented PTC from identifying and addressing corporate governance and compliance breakdowns at PTC China. The SEC and DOJ also charged that PTC and PTC China failed to control for the significant corruption risk inherent in using third parties to develop relationships with government customers. Specifically, PTC failed to conduct meaningful due diligence on its Chinese business partners with respect to corruption risks or anti-corruption controls.

Consistent with recent enforcement trends, the SEC and DOJ each described the extent of PTC and PTC China's cooperation with the government's investigation. Upon learning of the improper payments to Chinese officials in 2011, PTC engaged independent counsel and an independent forensic consulting firm to conduct an investigation. PTC then voluntarily disclosed the results of its investigation to the government and cooperated in the government's investigation. PTC also implemented extensive remedial measures to enhance FCPA compliance. As a result of these actions, PTC China received a reduced penalty. But PTC China did not receive voluntary disclosure credit or full cooperation credit from DOJ because, at the time of its initial disclosure, it failed to report relevant facts that it had learned during its investigation and did not disclose those facts until the department uncovered additional details independently and brought them to PTC's attention.

III. Conclusion

The PTC settlement highlights a number of important points, including:

- Continued enhanced focus on individuals in FCPA matters by the SEC and DOJ, not only for potential individual liability, but also to assist in developing possible cases against companies.
- The need for effectively written and implemented anti-corruption policies and internal controls.
- The importance of conducting appropriate due diligence on business partners, and the risks of not doing so.

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