CORPORATE COUNSEL
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corpcounsel.com | April 15, 2014

FCPA and Sarbanes - Oxley Combo = Higher Lawsuit Risk

From the Experts

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Stricter enforcement of the Foreign Corrupt Practices Act, combined with Sarbanes-Oxley's accounting requirements and an aggressive plaintiffs bar, has increased the litigation risk for public companies and their executives. Although the FCPA preceded SOX by 30 years, the internal controls, rules and compliance regime imposed by SOX forced companies to tie their FCPA compliance programs to their financial control and reporting to avoid additional liability for themselves, their directors and their executives from government agencies or shareholders.

After enactment of the FCPA, the number of civil suits filed against companies and directors based on the FCPA was insignificant. SOX reporting requirements and the increase in FCPA enforcement kindled an increase in such civil actions. Although the FCPA contains no private right of action, companies, their directors and officers are vulnerable to civil litigation in multiple ways after FCPA-related activity is reported. Immediately after the required public disclosure of an expensive regulatory investigation or government settlement, they may be named in derivative lawsuits alleging breaches of fiduciary duty, oversight and disclosure failures and fraud--or in securities fraud class action suits alleging SOX and/or FCPA violations.

There are four principal ways in which companies and their executives can be exposed in connection with FCPA-related activity:

- Criminal exposure from the U.S. Department of Justice or civil enforcement by the Securities and Exchange Commission from the FCPA investigation.
- Either the initial disclosure of the investigation or a subsequent settlement with the DOJ and/or the SEC (including any fines or disgorgement) can lead to follow-on shareholder civil litigation filed in state or federal court or both.
- Directors and senior executives may also face personal civil or criminal liability under the FCPA arising, in part, from a failure to meet their SOX obligations, including the certification that internal controls are robust and the books and records are accurate; or the audit committee's failure to meet its increased oversight responsibilities under SOX.
- Foreign executives who work for U.S. companies outside the U.S. who sign SOX certifications and sub-certifications can be subject to FCPA enforcement actions in the United States.

Shareholder Lawsuits Triggered by FCPA Investigation

Shareholder lawsuits are often triggered soon after and, sometimes,

within days, of the disclosure of an investigation. For example:

- Hercules (disclosure on April 7, 2011; suit filed April 27, 2011);
- Hewlett-Packard (disclosures in late 2013 led to suit in February 2014);
- Parker Drilling (detailed disclosures made in May 2010; suit in June 2010, dismissed in 2013);
- SciClone (disclosed in September 2010; suit filed four days later and settled in October 2011); and
- Wal-Mart (*New York Times* article on April 21, 2012; shareholder suits began April 25, 2012).

And, on the heels of announcements of FCPA settlements with the government, shareholder actions were asserted against companies such as Baker Hughes, Halliburton, Johnson & Johnson and Tidewater.

Typically, shareholder derivative suits allege that directors, officers and/or audit committee members breached their fiduciary duties by failing to oversee internal control systems, thereby subjecting the company to harm from: (i) the FCPA violation itself; (ii) the cost of cooperating with the government; and (iii) any civil or criminal penalties. Less frequently, derivative actions also allege direct FCPA violations by directors and officers for personally profiting from or approving bribes. Derivative suits in most states are subject to stringent demand requirements. As a result, many derivative lawsuits fail, but only after the company expends significant time, effort and money to defeat the claim.

Securities Fraud Class Actions Triggered by Misstatements

The other common type of FCPA-related shareholder lawsuits are securities fraud class actions. Plaintiffs typically allege that the company's disclosures, and the included SOX certifications, are misrepresentations or omissions in violation of Section 10(b)(5) of the Exchange Act and its corresponding Rule 10b-5 (which prohibits any "manipulative device or contrivance") or Section 14(a) of the Exchange Act (which addresses misstatements in proxy statements). Plaintiffs troll through any and all disclosures to find potential misstatements after an FCPA disclosure or revelation of a settlement, including disclosures in merger agreements or proxy statements and target the SOX disclosures concerning internal controls in connection with the FCPA books and records requirements. These cases are also subject to dismissal because of the need to meet higher fraud-based (particularity pleading) standards.

Recent case law suggests that companies are now more likely to face shareholder litigation in both federal and state courts simultaneously. After *The New York Times* story, a dozen cases were asserted against Wal-Mart in both federal and Delaware state court. Both the federal lawsuits and state cases were consolidated in their respective courts. The federal district court then stayed its case until the resolution of the Delaware cases. But, in December 2013, the Eighth Circuit reversed the district court's stay because of a federal securities claim in the federal action that could not be pursued in state court. *Cottrell v. Duke*, 737 F.3d 1238, 1242 (8th Cir. 2013). Wal-Mart and its directors must now defend FCPA-related civil actions in two venues simultaneously. It is now much more likely that plaintiffs will assert both federal and state claims in the same action creating the risk of inconsistent results and increased costs; since the securities claims are not derivative, they are also not limited by state demand rules.

If a shareholder case is not dismissed, the price of settling can be vastly more than the payment to the government. For example, UT Starcom, Inc., paid $30 million to settle a securities fraud case, even though the underlying FCPA violations were resolved for a total of $3 million with the DOJ and SEC. And, if large payments are made to the government succeeding payments to plaintiffs may increase the injury. For example, Johnson & Johnson paid a $21.4 million penalty to resolve FCPA criminal charges with the DOJ and $48.6 million to settle a SEC civil action, and then paid plaintiffs lawyers an additional $10.5 million for fees and expenses.

The resolution of shareholder suits can also require companies to agree to compliance regimes. For example, Johnson & Johnson and Maxwell Technologies included compliance measures in their settlements with shareholders that in many respects mirrored the enhanced compliance programs and internal controls included in their agreements with DOJ and the SEC. Maxwell resolved criminal and civil violations of bribery and book and records provisions with DOJ and the SEC for approximately $13.65 million in January 2011 and agreed to implement enhanced compliance measures. And then in 2012, Maxwell paid $3 million and agreed to similar FCPA compliance provisions negotiated with plaintiffs to settle a derivative suit.

Executives and Board Members May be Held Accountable

Shareholder suits are not the only risk for directors and executives from the interaction between SOX and the FCPA. Liability for individual directors and officers has increased over the years as the SEC and DOJ have reaffirmed in many public statements by the leadership of both agencies their commitment to holding individuals accountable. The SEC and DOJ have warned to expect more such actions in 2014.

To cite but one example, company executives, even at foreign subsidiaries, who sign false SOX certifications and sub-certifications that fail to disclose FCPA-related activity may be held personally accountable, either in a civil enforcement action brought by the SEC or in a criminal indictment filed by DOJ, after the company has resolved its investigations with the DOJ and the SEC and settled shareholder litigation. In October 2013, DOJ filed charges against Alain Riedo, a Swiss national and former executive of Maxwell. He was alleged to have knowingly signed false sub-certifications as part of the SOX process, falsely made 10-Q SOX certifications, recorded bribes as legitimate expenses, sent false books and records to the U.S. and caused false records to be included in SEC filings. Riedo is currently a fugitive.

The SEC is also pursuing foreign executives in FCPA actions as the result of, among other things, their allegedly false SOX certifications and sub-certifications. Specifically, three former Magyar Telekom executives now face an enforcement action in New York arising from, among other things, their allegedly submitting false sub-certifications and auditor's letters that were incorporated into the company's U.S. public filings. And in February 2014, Judge Scheindlin imposed record fines in connection with a default judgment imposed upon two former Siemens executives who refused to appear in an SEC enforcement action filed in New York. The two former Siemens executives still face criminal charges in New York.

The combination of the FCPA and SOX, and the follow-on shareholder civil litigation reemphasizes the need for internal controls sufficient for SOX purposes with a strong anti-corruption component. For companies and their directors and executives, a compliance failure or an internal control weakness can lead to catastrophic liability. In order to safeguard against these liabilities, companies should take the following steps:

- Ensure that your company's FCPA compliance program is coordinated with the SOX program. Unlike SOX, the FCPA has no materiality threshold, so a certification that the internal controls are strong should include an evaluation of the anti-corruption component to avoid a false certification.
- Have senior management and the audit committee exercise active oversight over FCPA-related activity. Clearly document and publically disclose the role of senior management and the audit committee with FCPA oversight.
- Senior management and outside counsel should inform your company's board of directors of corruption risks in both ongoing operations and in acquisitions. Ignorance is not an excuse.
- Monitor and review your company's compliance program regularly. It is better to create a compliance program when a company is not under duress from the government and not negotiating with plaintiffs lawyers.
- If your company is the subject of an FCPA investigation, provide ongoing and fulsome public disclosures so that there can be no omission-based disclosure claim as part of shareholder litigation. Retain outside counsel to manage the investigation.
- As part of your company's compliance training, ensure that all executives who sign SOX certifications and sub-certifications are aware that the certifications are not merely pro-forma, but rather can lead to significant U.S. criminal and civil liability both for the parent company and individuals.
- Have senior management set a clear tone of compliance with zero-tolerance for corruption.

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Anker concentrates on complex commercial and criminal litigation involving a wide variety of industries, representing clients in New York state courts, federal courts across the country, in government investigations and arbitration tribunals. He regularly represents individuals and foreign officials in FCPA matters; he has represented individuals in FCPA investigations in the telecommunications and resource industries in Europe and Africa and in international parallel investigations.

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