

## *Preparing for Shareholder Lawsuits When Dealing with Foreign Corrupt Practices Act Investigations*

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The impact of the continued focus by the Department of Justice (“DOJ”) and the Securities and Exchange Commission (“SEC”) on enforcing anti-corruption laws—most notably the U.S. Foreign Corrupt Practices Act (“FCPA”)—routinely reaches beyond the enforcement actions themselves. More and more companies announcing FCPA resolutions—or often merely the initiation of FCPA investigations—find themselves the subject of collateral civil actions. Indeed, shareholder litigation related to FCPA investigations is now almost routine. Companies that have been the target of such lawsuits in recent years include:

- Baker Hughes Incorporated
- Hewlett-Packard Company
- Hercules Offshore, Inc.
- Parker Drilling Company
- Pride International, Inc.
- SciClone Pharmaceuticals, Inc.
- Siemens AG
- Tidewater Inc.
- Wal-Mart Stores, Inc.

While the Baker Hughes and Hewlett-Packard cases were commenced following resolution of government actions, the Hercules, Pride, Parker Drilling, and Wal-Mart actions were initiated while the investigations were ongoing. Wal-Mart, in fact, is currently involved in contentious civil litigation, including a series of disputes in Delaware Chancery Court concerning the documents it must provide to shareholders investigating alleged malfeasance by the Wal-Mart board.<sup>1</sup>

These lawsuits share many basic characteristics, and companies facing an FCPA investigation can take a variety of steps to positively position themselves for the prospect of follow-on civil litigation.

## **Anatomy of Common FCPA-Related Shareholder Lawsuits**

FCPA-related shareholder lawsuits generally take two forms: derivative actions and securities fraud class actions. A derivative claim is a claim brought by a shareholder on behalf of the company to remedy harm purportedly done to the company. Such claims generally involve alleged actions, omissions, and/or mismanagement by the executives and/or directors that plaintiffs assert injured the company. The claims are advanced by individual shareholders who argue that the company will not act because it is controlled by the very persons whose conduct is at issue. For that reason, an individual shareholder must act on the company's behalf. Any recovery is paid to the corporation, but the attorneys pursuing the claims are often entitled to attorneys' fees for the work performed—thus incentivizing the plaintiffs' securities bar to pursue these actions.

Similarly, a securities fraud claim is brought by shareholders of the corporation. However, unlike a derivative action, a securities fraud claim is made on behalf of the shareholders themselves. These lawsuits are generally advanced as class actions alleging violations of the federal securities laws such as Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"). Here, plaintiffs make a misrepresentation or omission claim related to how the company disclosed, or failed to disclose, its FCPA compliance efforts and/or issues. Plaintiffs often point to the existence of the FCPA investigation and/or its resolution as evidence that the company knew it had FCPA problems and/or weaknesses in its internal controls, its compliance program, or both, but failed to disclose them. According to plaintiffs, when the truth about FCPA non-compliance was revealed, the revelation resulted in a material negative impact on the company's stock price. Any recovery in a class action goes directly to the shareholder class.

### ***Shareholder Derivative Actions***

In the FCPA context, shareholder derivative actions generally target management and the board for their purported actions or inaction.<sup>2</sup> While derivative actions can be brought on the basis of FCPA violations committed directly by the officers or directors of a company, more commonly plaintiffs assert what is known as an "oversight claim." This type of claim alleges that the officers and directors are charged with the oversight of corporate activities, including FCPA compliance, and that the FCPA issues being investigated demonstrate a failure to properly oversee this critical aspect of corporate affairs. This failure of oversight is characterized as a breach of fiduciary duty; the damages identified are all the harms the company has suffered as a result of the FCPA violations (or alleged violations), including the costs of the investigation.

The nature of the shareholder derivative claim as a claim brought on behalf of the corporation creates certain procedural barriers plaintiffs in most jurisdictions must overcome in order to proceed.<sup>3</sup> To pursue a derivative claim, a shareholder must either (a) make demand on the corporation that the claim be pursued by the corporation, or (b) explain why demand would be futile and the shareholders should be allowed to proceed on the company's behalf. The basis for this requirement is the notion that corporations are run by their boards and that individual shareholders should not usurp the board's decision-making authority on central issues such as whether to bring a lawsuit. Courts recognize, however, that in certain cases a board may have a conflict of interest or lack of independence that prevents it from fairly considering whether a suit should be brought by the company. In FCPA-related cases, plaintiffs generally attempt to demonstrate the required conflict or lack of independence by claiming that a majority of the directors who would evaluate a shareholder demand face a substantial likelihood of liability from the lawsuit itself, and thus cannot fairly consider whether such a lawsuit should be pursued. Where a conflict of interest or lack of independence is shown—and the standard is usually a high one—demand is "excused," and the shareholder is allowed to pursue the claim on the corporation's behalf.

Due to the potentially disabling effect of derivative litigation on the ability of the corporation to manage its own affairs, courts are reluctant to find demand is excused. For example, in 2007, a shareholder brought a derivative action on behalf of Baker Hughes against various current and former directors and officers following the company's disclosure of FCPA violations in several countries, a settlement with the government that included \$44 million in penalties and fines (then the largest amount on record), and a guilty plea by a subsidiary.<sup>4</sup> In dismissing the derivative action, the court found the following facts insufficient to excuse demand: (i) a prior 2001 FCPA settlement with the DOJ and SEC, (ii) two lawsuits filed by former employees claiming they were fired for refusing to bribe a foreign official or for reporting an alleged bribe, (iii) a third employee lawsuit claiming endangerment resulting from Baker Hughes' supposed failure to follow through with a bribe, and (iv) the renewed investigation and settlement.<sup>5</sup>

In cases where a shareholder chooses to make a demand, the board must consider whether it is in the best interest of the corporation to pursue a claim. Procedures for handling shareholder demands vary. Sometimes the full board will consider the demand. On other occasions, companies choose to appoint a special committee comprised of directors who qualify as disinterested and independent to decide whether any claims should be pursued. In certain circumstances, the board may appoint new directors to ensure a sufficient number of independent directors are available to serve on the special committee. When a board or special committee chooses not to bring claims, a shareholder must demonstrate that the demand was wrongfully refused to pursue derivative claims. If a majority of the board or special committee is unconflicted and can demonstrate the decision was made on an informed basis and in good faith—in other words, that it was a rational business decision—a court is unlikely to find the demand was wrongfully refused.

## ***Shareholder Securities Fraud Actions***

While less prevalent than derivative actions, securities fraud actions are also a common response to FCPA investigations. These claims target the company itself, and usually some directors or officers as well. In such actions, shareholders allege that the company's disclosures—those made before, during, and after the investigation—contained material misrepresentations or omissions, often regarding the adequacy of the company's internal controls. According to plaintiffs, these alleged misrepresentations violate federal securities laws, including Section 10(b) of the 1934 Act and Rule 10b-5.

Section 10(b) and Rule 10b-5 together prohibit the making of false or materially misleading statements or omission in connection with the purchase or sale of any security.<sup>6</sup> Where such claims follow FCPA settlements in which companies admit to not having maintained accurate books and records, a shareholder would seem to have the building blocks for a claim. But, actions brought under these rules are subject to stringent pleading requirements.<sup>7</sup> To survive a motion to dismiss and pursue a securities fraud claim, one must strongly infer from the shareholders' complaint that the persons making any misleading statements knew that the statements were false when made.<sup>8</sup> Personal and concrete benefits from the fraud, deliberate participation in illegal behavior, access to information indicating public statements are inaccurate, and failure to verify information where a duty to oversee exists have been found to sufficiently satisfy the knowledge requirement.<sup>9</sup> In addition, shareholders must allege not only who, what, when, and where regarding each purportedly misleading statement, but also must show that they relied on the misleading statements and that such reliance was the cause of their losses.

As with derivative actions, courts are hesitant to allow shareholders to pursue securities fraud actions even following the resolution of an FCPA investigation. For instance, following Siemens' \$800 million settlement with the U.S. government for alleged fraud, bribery, and other illegal and/or corrupt activities, a shareholder securities fraud lawsuit was filed. The plaintiffs alleged the company made materially false and misleading statements concerning Siemens' ability to continue its operations,

generate revenues, and meet earnings expectations after ending the violative conduct.<sup>10</sup> Despite the claimed \$1.5 billion in damages purportedly suffered by Siemens' shareholders when the truth was revealed,<sup>11</sup> plaintiffs' claims were dismissed as too general because they relied on defendants merely being privy to confidential information and failed to "specifically identify . . . reports or statements" provided to management that contained facts contrary to the company's public statements.<sup>12</sup>

## **A Comprehensive Strategy: Recognizing Where and How an Investigation May Impact Related Shareholder Lawsuits**

The various defenses available to defendants in FCPA-related shareholder suits have not reduced their prevalence, and plaintiffs have had several notable successes.<sup>13</sup> For these reasons, a company faced with an FCPA investigation should consider what it can do to increase the likelihood of positively resolving any subsequent shareholder action. Many of these actions involve steps that are best taken during the pendency of an investigation.

### ***Public Disclosures***

Public disclosures related to FCPA risks and investigations necessarily play a significant role in shareholder litigation. These disclosures often provide the basis for shareholder complaints and can also be utilized in preparing a response to such complaints.<sup>14</sup> To that end, companies should consider what disclosures are being made—both before and during an FCPA investigation—in three respects:

- Are FCPA risks being disclosed? Long before an FCPA issue arises, companies should evaluate their FCPA risks and craft appropriate disclosures as required by applicable rules. Claims that material risks went undisclosed are likely to be incorporated into shareholder claims that a company's SEC filings were misleading, even if such claims ultimately fail.
- Are FCPA compliance efforts being disclosed? A company's disclosures regarding the existence of an FCPA compliance program and FCPA controls, as well as steps taken to improve or implement the program, may be useful in responding to shareholder claims, particularly when those disclosures occur in advance of any FCPA issue or shareholder dispute. For example, where failure to oversee claims are made, effective disclosure of compliance activities and appropriate disclosure of compliance program enhancements may provide an important counter to allegations that board members or managers consciously disregarded their duty to implement and monitor FCPA-related controls. On the other hand, a lack of disclosure regarding compliance efforts may be used to assert the company had no such programs or controls in place, regardless of the accuracy of these allegations.
- Are progressive disclosures being made during the investigation and resolution process? Companies engaged in government FCPA investigations should consider making progressive disclosures, if appropriate. That is, a company should evaluate whether disclosing more than just the fact that an investigation has commenced is warranted. Particularly where an investigation has continued for several years, disgruntled shareholders may be able to allege that a company must have learned *something* material that required disclosure during the intervening years. Such a claim may have even more gravity when a summary disclosure is compared to the detailed factual information provided in the resolution papers publicly available at the investigation's conclusion. Progressive disclosures help rebut shareholder claims that the company failed to timely disclose material information and thus caused damage to shareholders. They also can help condition the marketplace to the type of resolution that ultimately is likely to occur, reducing the prospect of sudden share price movement. To this end, companies involved in FCPA investigations should evaluate their

disclosures periodically with a view toward whether it is advisable to disclose information that gives some insight into the character of the issues under investigation. These disclosures may include topics such as the geographic areas in which the investigation is occurring, the business units involved, the type of conduct at issue, the potential that business relationships/activities will be impacted due to the investigation, and some sense of the likelihood that a negative result may occur. In addition, as the company moves toward resolution, some disclosure on the range of potential outcomes may be useful. Finally, throughout the process, companies should consider whether any disclosures previously made need to be updated, for example, if the scope of the investigation broadens.

## ***Privilege Issues***

When engaged in government—or even internal—investigations, companies must make critical decisions impacting their ability to effectively maintain the attorney-client and work product privileges. To help avoid undesirable privilege waiver, companies should consider two important issues:

- Structure of the investigation: Application of the attorney-client privilege to corporations is complicated and the subject of conflicting court opinions. In an investigation setting, creating a structure that protects privileged information while facilitating a thorough investigation must be a priority. At the outset, a structure for the investigation should be established that clearly articulates who the client is, who personifies the client, how reporting regarding the investigation will occur, and how that reporting will be disseminated. That structure needs to be respected throughout the investigation and deviations made with the recognition that they could result in a privilege waiver. For example, some courts have indicated that when a board committee conducts an investigation, the privilege rests with that committee alone and sharing privileged materials with other board members or corporate officers constitutes waiver.<sup>15</sup> While these holdings are suspect, decisions about investigation structure and dissemination of material should be made in light of them.
- Impact of privilege waiver beyond the investigation: At some point during an investigation, a company may consider producing privileged information to an investigating body. Most commonly this comes in the form of a voluntary waiver of privilege. While there are often significant benefits to such a production, companies should be aware that disclosure of privileged information may waive the privilege in subsequent lawsuits as well. Indeed, the selective waiver doctrine, which provides that waiving privilege with respect to an investigating governmental agency does not waive privilege as to third parties, has been rejected by all but one federal court to consider it.<sup>16</sup> Thus, while disclosure of privileged material in an investigation may be necessary and/or strategically desirable, such disclosure should be evaluated, at least in part, based on the impact it may have in other litigation.

## ***Resolution Papers***

When a company finds itself negotiating the resolution of an investigation with the government, it should evaluate whether there are useful facts it can incorporate in the resolution papers to better position itself to effectively respond to follow-on shareholder litigation.<sup>17</sup> Depending on the circumstances, it may be useful to consider including information related to:

- the existence of an FCPA compliance program and FCPA-related internal controls pre-violation/investigation;



- any actions taken by the company to evaluate, improve, or enhance its FCPA compliance program and FCPA-related controls prior to the discovery of the events at issue;
- any actions taken by the company to evaluate, improve, or enhance the company's FCPA compliance program and FCPA-related controls prior to resolution of an investigation;
- the discovery of the issue by the corporation, if internal efforts uncovered the issue;
- the thoroughness of the investigation conducted; and
- any difficulties faced by the company in uncovering the violative conduct and/or evidence from the investigation that the wrongful conduct was designed to, and did in fact, keep management and the board unaware of events.

The inclusion of the language described above may help address allegations that company directors and managers knowingly disregarded their duty to oversee implementation and monitoring of controls, hastening the resolution of shareholder litigation resulting from the government's FCPA investigation.

While every anti-corruption investigation has unique characteristics requiring a carefully tailored approach, the crafting of that approach is best undertaken mindful of the potential for follow-on shareholder litigation. Indeed, awareness of how investigation decisions impact collateral civil litigation creates the prospect for better management and resolution of FCPA-related civil suits.



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<sup>1</sup> In response to a books and records action brought against Wal-Mart, Chancellor Strine ordered the company to produce, among other things, contemporaneous documents regarding how Wal-Mart "deals with internal investigations, FCPA compliance, and the decisions as to how the investigation" was undertaken, including materials for which Wal-Mart had claimed a privilege. *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, Del. Ch., C.A. No. 7779-CS, Strine, C. (May 20, 2013), Tr. at 85–92, 112.

<sup>2</sup> See, e.g., *Freuler v. Parker*, 803 F. Supp. 2d 630, 641–43 (S.D. Tex. 2011).

- <sup>3</sup> In most jurisdictions, the law of the state of incorporation—usually Delaware—governs the procedure by which a shareholder may bring a derivative action.
- <sup>4</sup> *Midwestern Teamsters Pension Trust Fund v. Baker Hughes, Inc.*, C.A. No. H-08-1809, 2009 WL 6799492, at \*3 (S.D. Tex. May 7, 2009).
- <sup>5</sup> *Id.* at \*7.
- <sup>6</sup> 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.
- <sup>7</sup> See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319–23 (2007).
- <sup>8</sup> See, e.g., *San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 808 (2d Cir. 1996); *Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 532 (5th Cir. 2008).
- <sup>9</sup> *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Cap., Inc.*, 531 F.3d 190, 194 (2d Cir. 2008 (quoting *Novak v. Kansas*, 216 F.3d 300, 311 (2d Cir. 2000))).
- <sup>10</sup> Memorandum and Order (Dkt. No. 36), at pp. 3–5, *Christine Johnson v. Siemens AG*, Case No. 09-CV-5310 (JG) (RER) (E.D.N.Y. Mar. 31, 2011).
- <sup>11</sup> *Id.* at pp. 8–9.
- <sup>12</sup> *Id.* at p. 29 (citing *Novak v. Kansas*, 216 F.3d 300, 309 (2d Cir. 2000)).
- <sup>13</sup> For example, in October 2011, SciClone Pharmaceuticals, Inc. announced it would pay \$2.5 million in attorneys' fees as part of a settlement of an FCPA-related derivative claim. See Stipulation of Settlement, Ex. 99-2 to SciClone Form 8-K filed with the SEC Oct. 12, 2011 ("SciClone Stipulation"), at 20. In 2012, Maxwell Technologies, Inc. announced that it would pay \$3 million in attorneys' fees as part of a derivative case settlement arising out of the company's FCPA investigation. See Stipulation of Settlement, Ex. 99-2 to Maxwell 8-K filed with the SEC Feb. 15, 2012 ("Maxwell Stipulation"), at 16. Both companies also agreed to undertake various additional compliance program activities. See SciClone Settlement at 8–18; Maxwell Settlement at 8–14.
- <sup>14</sup> Courts are often willing to consider and/or take judicial notice of a company's SEC filings at the motion to dismiss stage. See, e.g., *Citadel Equity Fund Ltd. v. Aquila*, 168 Fed. App'x 474, 476 (2d Cir. 2006) (explaining that taking judicial notice of an SEC filing was "properly within the court's discretion on a motion to dismiss"); *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (upholding trial court's consideration, on a motion to dismiss, of SEC filings used to ascertain facts appropriate for judicial notice, i.e., those "not subject to reasonable dispute"); *Lovelace v. Software Spectrum, Inc.*, 78 F.3d 1015, 1018 (5th Cir. 1996) (holding that SEC filings may be considered in a motion to dismiss).
- <sup>15</sup> See, e.g., *In re OM Grp. Sec. Litig.*, 226 F.R.D. 579, 591–94 (N.D. Ohio 2005) (holding that audit committee waived attorney-client privilege as to presentation shared with corporation's board of directors); see also *New Jersey v. Sprint Corp.*, 258 F.R.D. 421, 442 (D. Kan. 2009) (holding that, under Kansas law, objection and instruction to witness not to answer deposition questions regarding special litigation committee information was improper where corporation and committee failed to establish that committee information was not shared with the board or third parties). But see *Ctr. Partners, Ltd. V. Growth Head GP, LLC*, 981 N.E.2d 345, 364 (Ill. 2012) (holding that "subject matter waiver does not apply to the extrajudicial disclosure of attorney-client communications not thereafter used by the client to gain an adversarial advantage in litigation").
- <sup>16</sup> See *In re Pacific Pictures, Corp.*, 679 F.3d 1121, 1127 (9th Cir. 2012) (rejecting selective waiver doctrine); *In re Qwest Commc'ns Int'l*, 450 F.3d 1179, 1192 (10th Cir. 2006) (same); *Burden-Meeks v. Welch*, 319 F.3d 897, 899 (7th Cir. 2003) (same); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 306–07 (6th Cir. 2002) (same); *U.S. v. Mass. Inst. Of Tech.*, 129 F.3d 681, 686–87 (1st Cir. 1997) (same); *Genetech, Inc. v. U.S. Int'l Trade Comm'n*, 122 F.3d 1409, 1417 (Fed. Cir. 1997) (same); *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 236 (2d Cir. 1993) (same); *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1430 (3d Cir. 1991) (same); *In re Martin Marietta Corp.*, 856 F.2d 619, 623 (4th Cir. 1988) (same); *Permian Corp. v. U.S.*, 665 F.2d 1214, 1221–22 (D.C. Cir. 1981) (same). But see *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1978) (holding that disclosure of privileged materials to the SEC during the course of an investigation resulted in a waiver of the attorney-client privilege "limited" to the investigation itself and establishing the "selective waiver doctrine").
- <sup>17</sup> Once filed, any resolution papers are a matter of public record and, in cases where a shareholder waits until after resolution to file lawsuits, are often at least partially incorporated into a shareholder's complaint. For this reason, courts may consider resolution papers as early as the motion to dismiss stage. Cf. *Gen. Elec. Capital Corp. v. Lease Resolution Corp.*, 128 F.3d 1074, 1081–82 (7th Cir. 1997) (holding that in deciding a motion to dismiss, a trial court may take judicial notice of court records); see also *supra* n.14.