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Focus

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The renewed focus on the Foreign Corrupt Practices Act by the Department of Justice and the Securities and Exchange Commission has fueled a trend by the plaintiffs' bar to file "follow-on" securities class action cases and shareholder derivative suits based on the alleged or admitted violations of the act. Class action and derivative plaintiffs rely on FCPA violations to support claims for securities fraud under Section 10(b) of the Securities Exchange Act of 1934, and breaches of a corporate director's Caremark duty of care, established in *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). Plaintiffs also have begun to rely on FCPA allegations of corruption and bribery to support claims under the Racketeer Influenced and Corrupt Organizations Act.

These follow-on actions are a patent attempt by plaintiffs to circumvent the strictures of the FCPA, which does not authorize a private right of action; and the refusal by courts to read such a right into the statute. See, e.g., *Lamb v. Phillip Morris*, 915 F.2d 1024 (6th Cir. 1990). Plaintiffs who rely on FCPA-related allegations to inform their Section 10(b) class action complaints are subject to the rigorous pleading standards under the Private Securities Litigation Reform Act. These plaintiffs also must clear hurdles set by the Supreme Court's recent series of defense-oriented decisions in *Dura Pharmaceuticals Inc. v. Broudo*, 544 U.S. 336 (2005), *Tellabs Inc. v. Makor Issues & Rights Ltd.*, 551 U.S. 308 (2007), *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 2009 DJDAR 7005, which increased a plaintiff's pleading burden on loss causation, scienter, and in surviving a 12(b) motion to dismiss, as well as the decision in *Stoneridge Investment Partners LLC v. ScientificAtlanta Inc.*, 128 S.Ct. 761 (2008), which

re-affirmed precedent that no scheme liability exists under Section 10(b). Given the hurdles plaintiffs must overcome when filing follow-on FCPA actions, they must view these claims as the next stock option backdating bonanza or they would not be expending so much energy on creating legal maneuvers to leverage large government FCPA settlements into a private actions. As the number of private actions increase, it becomes more and more important for companies to review their compliance programs and avoid FCPA violations from the outset.

To date, the 9th Circuit is the only federal appellate circuit to have considered FCPA-related Section 10(b) claims and in doing so, has applied Supreme Court precedent to reach its decisions. In *Glazer Capital Management LP v. Magistri*, 549 F.3d 736 (9th Cir. 2008), the 9th Circuit upheld the dismissal of an FCPA-grounded securities class action matter against InVision and some of its directors on the grounds that the plaintiffs had failed to adequately plead scienter under the stringent standards set by the Private Securities Litigation Reform Act and *Tellabs*. As is typical in this type of case, the plaintiffs filed their securities class action case shortly after InVision publicly announced that it had met with the Justice Department and the SEC concerning the company's voluntary disclosure of an internal investigation in connection with a merger that identified possible offers of improper payments to facilitate sales. InVision made the announcement on July 30, 2004, and the plaintiffs filed their complaint on Aug. 4, 2004.

To make their Section 10(b) fraud allegations, the plaintiffs focused on three alleged misstatements in a 60-page merger agreement between InVision and GE, which InVision included in its Form 10-K. In those statements, InVision warranted that it was in compliance with the law. The plaintiffs alleged that the warranties were false and misleading because the company

was aware of the bribery scheme at the time it made the statement. The 9th Circuit affirmed the dismissal of the case because the plaintiffs had failed to plead with the required particularity that the named directors knew that the statements were false at the time that they were made. The court also rejected the so-called "collective scienter doctrine," and refused to permit the plaintiffs to rely on InVision's alleged collective knowledge of the falsity to carry the day.

In contrast, in an unpublished 2007 decision, the 9th Circuit reversed, in part, the dismissal of an FCPA-based Section 10(b) claim in *Milton Arbitrage Partners LLC v. Syncor International Corp.*, No. 05-55748 (9th Cir. June 12, 2007) (unpublished), finding that the plaintiffs had pleaded facts that demonstrated that certain of Syncor's directors were aware that the company's overseas sales success was due to bribery, and not to legitimate sales techniques. In this case, the plaintiffs relied on statements made by confidential witnesses, who claimed that three Syncor directors knew about the bribery at the time the statements were made. Publicly available documents reflect that in April 2009, the parties finalized a \$15 million settlement.

While plaintiffs' success rate with FCPA-related 10(b) actions appears to be mixed, it is likely they will continue to file such claims where public disclosure of an FCPA investigation or violation adversely affects a company's stock price. According to a January 2009 study published by NERA, an economic consulting firm, settlements of FCPA-related securities class action cases totaled approximately \$84 million during the 2002-2008 period. Notably, NERA found that plaintiffs tended to file follow-on cases when the public disclosure of FCPA-related admissions or allegations caused a significant drop in the company's stock price. In five of the 32 FCPA-related public disclosures examined by NERA, where the decline in stock price exceeded 10 percent,

plaintiffs filed securities fraud class action matters. Given these statistics, it is likely that as the number of FCPA settlements increases, plaintiffs will work to refine their legal theories and become more successful in advancing FCPA-related class actions.

Plaintiffs also are using FCPA disclosures as the impetus for shareholder derivative actions. The ink was barely dry on the FCPA settlement reached by Halliburton and KBR when the plaintiffs filed a derivative suit against Halliburton in Texas state court, seeking to recover from the individual directors the monies that the companies paid in settlement. The SEC and the Justice Department announced a settlement of alleged FCPA violations against the companies on Feb. 11, and the plaintiffs filed a derivative suit on May 14. The plaintiffs claimed that the directors breached their *Caremark* fiduciary duties of care by failing to detect and prevent the FCPA violations. Under *Caremark*, however, liability predicated on a board's failure to exercise oversight "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." Plaintiffs must plead facts with particularity that demonstrate that the directors "knew that they were not discharging their fiduciary obligations" and that they failed to act "in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities." *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

The plaintiffs in a derivative case filed in Texas federal district court recently learned just how difficult it is to meet the *Caremark* oversight standard. On May 26, Judge Vanessa Gilmore affirmed the magistrate's recommendation to dismiss a *Caremark* shareholder derivative suit that had been filed against Baker-Hughes shortly after it settled its FCPA case with the government. The plaintiffs had tried to recover the \$44 million in fines and penalties that Baker Hughes had paid to settle allegations with the Justice Department and the SEC. Another new trend in FCPA-related civil litigation can be seen in the Alcoa case, where the plaintiff attempted to tie FCPA and RICO allegations to form

the basis for civil recovery. Tying FCPA and RICO claims is significant because the civil RICO statute provides for treble damages. In the Alcoa matter, the plaintiff, a Bahraini government-owned aluminum smelter, alleged that an Alcoa subsidiary bribed Bahraini government officials to win aluminum ore supply contracts, and then charged the smelter inflated prices for aluminum ore. The plaintiff alleged that a criminal enterprise existed in Alcoa, which included several Alcoa subsidiaries and employees that engaged in a pattern of racketeering activity by bribing Bahraini government officials and extracting inflated prices from plaintiff for aluminum ore. The plaintiff further alleged that the payment of bribes in violation of the FCPA comprised the necessary "predicate act" for purposes of pleading a RICO claim, in addition to mail and wire fraud and other criminal violations. The bribery allegations leveled against Alcoa prompted the Justice Department to intervene and stay the case so that it could conduct a criminal FCPA investigation of Alcoa. That stay is still in place.

This new trend in FCPA-related civil actions serves as a warning signal to companies to be proactive and work to prevent FCPA violations in the first place. Frequent and thorough FCPA anti-bribery training programs for employees, a strong internal auditing program, rigorous due diligence on potential foreign agents before they are retained and careful FCPA-related due diligence in any acquisition should be on the menu of any successful FCPA compliance program.

If these efforts reveal FCPA red flags, companies should thoroughly investigate the facts and consider self-reporting any violations that are discovered. Both the SEC and the Justice Department look very favorably on companies that have strong FCPA compliance programs in place and self-report violations. Government fines and penalties are reduced and the damage to a company can be significantly mitigated. The company also should attempt to persuade the government to accept a deferred prosecution agreement to allow it to remediate the violations and bring

the company into compliance. If public disclosure becomes necessary, a company should ensure that the disclosure accurately and completely describes the situation and does not underestimate, or exaggerate the scope of the FCPA violations. Companies also need to consider the ramifications of the language used and factual disclosures made in the agreement to minimize the use of the agreement to support a civil follow-on action.

If a company finds itself facing a FCPA-related securities class action or shareholder derivative case, it should avail itself of the full arsenal of statutory and judicial defenses available under the Private Securities Litigation Reform Act, the defense-oriented interpretations of the statute in *Dura*, *Tellabs* and *Stoneridge*, the heightened pleading standard announced in *Twombly* and *Iqbal*, and the Delaware *Caremark* decisions and its progeny. In addition to asserting the legal barriers to these claims, a company should assemble a strong arsenal of facts to demonstrate that it has taken every reasonable action to protect the interests of the company and its shareholders, by instituting and adhering to an FCPA compliance plan, regularly conducting compliance audits, self-reporting violations, instituting government sanctioned remedial actions, and when necessary, entering into carefully crafted settlement agreements or deferred prosecution agreements. By instituting strong internal controls, a company will have more success in defeating plaintiffs' attempt to create a new FCPA private right of action.

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