Shareholder efforts to bootstrap FCPA violations into private securities cases meet with mixed success – key takeaways

Securities Litigation Alert

White Collar Crime Update

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The absence of a private right of action under the Foreign Corrupt Practices Act (FCPA) has motivated plaintiffs' attorneys to pursue indirect legal theories – often in the form of securities class actions, derivative actions, or books and records cases – in an effort to craft a recoverable private claim for corporate bribery. Typically, these attempts have relied on a company's disclosure of a government investigation or statements in a deferred prosecution agreement (DPAs) or settlement agreement between a company and a regulator in which the company admits facts about wrongful conduct and internal control failures. Plaintiffs' attorneys try to capitalize on these often full-throated admissions of wrongdoing to substantiate otherwise skeletal pleadings.

As recent cases show, however, even DPAs and regulatory resolutions with admissions do not necessarily make for a successful securities class action. Most securities fraud claims, like those in the recent case *Doshi v. General Cable Corp.*,[1] are dismissed. Only a smaller number proceed to discovery. This article analyzes recent trends in FCPA-based securities litigation.

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Legal framework

Admissions in DPAs or other corporate resolutions often embolden shareholders and plaintiffs' attorneys to think they have the requisite facts to meet the heightened securities fraud pleading requirements under securities laws, which include satisfying Rule 9b of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act (PSLRA). Most claims, however, are dismissed under the first element of federal securities fraud, which requires a material misrepresentation or omission by the defendant. To plead a material misrepresentation, a plaintiff must "specify each statement to have been misleading" and "why the statement is misleading." Despite the DPA admissions, plaintiffs often struggle to identify statements that rise to the level of a material misstatement.

Recent trends in FCPA-based securities cases

Doshi v. General Cable Corp.

The recent *Doshi* case provides a prime example of a claimant failing to satisfy the material misstatement element. Investors initiated this putative securities class action after the company agreed to pay approximately USD 76 million to the Department of Justice and the Securities and Exchange Commission to resolve an FCPA enforcement action concerning its foreign subsidiaries' conduct abroad. Piggy-backing off the government's allegations and the company's admissions in the settlement, shareholders alleged the company made three categories of false or misleading statements, each of which the court concluded was insufficient to state a claim:

- **Misstatements about policies and ethics.**The court held that general statements regarding the existence of policies and the company's commitment to abiding by the law were too vague and boilerplate to be material or misleading.
- **Misstatements about the efficacy of internal controls.**Although the court held that the company's disclosures in the government settlements confirmed that prior statements about the efficacy of its internal controls were misleading, the defendant did not know the statements were false at the time they were made and therefore lacked the requisite scienter.
- **Omissions regarding market risks.**The court held that the company had no duty to disclose risks until the consequences of the company's actions – that it was impossible for the company's foreign subsidiaries to operate without making improper payments – were "virtually certain."

A series of other cases, like *Doshi*, have carefully considered these same (or similar) allegations of FCPA-related corporate disclosures. In most cases, such statements have been held not actionable. As discussed below, however, in certain circumstances, admissions in FCPA resolutions can be evidence of a misstatement sufficient to support an action.

Statements about integrity, ethics, and compliance with law

Shareholders routinely fashion fraud claims around a company's statements about its compliance with the law, its reputation for integrity or its commitment to ethical conduct, all of which are arguably discredited following an FCPA-related settlement. Courts, however, have largely dismissed such public statements as mere "puffery" – corporate cheerleading upon which no reasonable person would rely. Explicitly aspirational statements, such as those in corporate codes of conduct, are considered outside the bounds of liability. So too are statements accompanied by qualifiers that make clear to the reader that they are corporate goals.

Under certain circumstances, however, generic statements about an organization's compliance with anti-bribery law may be actionable. In the *Eletrobras* FCPA/securities litigation,[2] the court found that the company's repeated statements emphasizing "its commitment to transparency and ethical conduct" were made in direct response to disparaging press reports implicating Eletrobras in the now infamous Operation Car Wash bribery scandal. The larger context in which the statements about the company's integrity were made suggested that the underlying purpose was to reassure investors, thus making the statements actionable.

Statements about the existence or effectiveness of internal controls

Another common category of statements upon which shareholders try to base a claim are statements from SEC

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filings or Sarbanes-Oxley Act (SOX) certifications relating to the quality of a company's internal controls. General statements about internal controls are generally not actionable because they are too vague or boilerplate. But some plaintiffs have successfully pled an actionable misstatement where the statements reflected an opinion on the efficacy of the program and the plaintiff was able to allege that the speaker was aware the opinion was false.

In *Doshi*, the court determined that statements in annual reports regarding the company's internal controls were actionable because the statements suggested that management had reviewed these controls and concluded they were effective, and plaintiffs pled facts to show that these conclusions were ill-founded. The court's conclusion rested in part on the company's admissions in government settlement agreements that management knew at the time of the representations that the company's internal controls were inadequate and facilitated improper payments. These additional facts elevated what would otherwise be a non-actionable general statement to an actionable basis for a claim.

Failure to disclose FCPA risk or payments

As a general matter, a company has no free-standing duty to disclose market or corruption risk or even uncharged wrongdoing. To be actionable, the lack of disclosure must make other disclosures materially misleading to investors. The risk of liability on this basis is most likely to arise where a company discusses the reasons for its success, thus creating an obligation to tell the whole story, even if that includes illegal conduct.

The recent cases involving *Rio Tinto*[3] and *Braskem*[4] are illustrative of this point. In the *Rio Tinto* case, shareholders alleged that the company committed securities fraud by failing to disclose that its financial success was due, at least in part, to business obtained by bribing government officials. After examining the company's public statements, however, the court concluded that the statements were not actionable because the company did not attribute its success to any particular cause.

In contrast, in *Braskem*, the court agreed with shareholders that the company's statements regarding the bases for the price it paid for certain raw material were actionable. The court so found because the company advanced a number of innocuous reasons for the low purchase price, but neglected to mention that the prices had been established pursuant to a side agreement the company procured by paying substantial bribes.

Failure to disclose FCPA investigation

A company's failure to disclose that it is being investigated by a regulator is generally not actionable. However, in *Menaldi v. Och-Ziff Capital Management Group*,[5] the court found that shareholders adequately pled that the company failed to disclose a contingent loss in violation of Generally Accepted Accounting Principles (GAAP) because the officers were aware that the company did business with high-risk parties in Africa *and* had received detailed SEC subpoenas describing the alleged misconduct. The court found that the government investigation triggered a "reasonable possibility" of an adverse impact on the company's financial position by way of a penalty or disgorgement order should the investigation conclude illegal conduct had occurred. Because GAAP mandated disclosure of the investigation, the company's failure to do so was held actionable.

Other areas of exposure

In addition to securities fraud claims, organizations facing allegations of FCPA violations risk exposure to other forms of shareholder litigation, including books and records inspections and derivative claims. Such litigation imposes an additional burden on an organization dealing with FCPA concerns and may result in substantial additional cost.

Fortunately, a robust corporate and board response to FCPA concerns may lower the risks associated with derivative claims resulting from potential or actual violations. Courts have rejected shareholder assertions of demand futility for derivative claims alleging improper oversight where a board took steps to address potential FCPA violations, including through an internal investigation led by outside counsel.[6] Moreover, where a plaintiff makes a demand before filing a derivative claim and the board refuses the demand, courts have found such refusal reasonable where the board first conducts a thorough investigation.[7]

Takeaways

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These cases suggest a few things companies might consider to limit their exposure to securities fraud claims following an FCPA-related resolution or other FCPA-related disclosures.

First and foremost, a robust and prompt response to FCPA concerns, including through investigation and remediation, substantially lowers the risk associated with shareholder litigation resulting from such concerns. If remediation is required, companies should consider both individual remediation (*ie*, through discipline) and systemic remediation (*ie*, through implementation of policies and procedures establishing an effective control environment). Relatedly, companies should consult disclosure counsel to determine when a duty to disclose an ongoing investigation or illegal conduct may arise.

Second, companies should take care in the wording of any admissions in DPAs or resolutions entered with government regulators and be sensitive to the risk of downstream securities litigation based on these admissions. Furthermore, companies should strive to negotiate language in the resolution papers reflecting, to the maximum extent possible, self-disclosure, extraordinary cooperation, and the role of the audit committee and board in conducting the internal investigation.

Third, companies should be mindful when drafting disclosures pertaining to such factors as their anti-corruption commitment, effectiveness of internal controls, source of success, or risks they face in foreign markets. Every business wants to emphasize its positive attributes in public statements, but tempered language, with appropriate caveats, can help avoid misinterpretation.

Learn more by contacting any of the authors.

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[1] *Doshi v. General Cable Corp., et al.,* No. 2:17-cv-25 (WOB-CJS), 2019 WL 1965159 (E.D.Ky. Apr. 30, 2019).

[2] *In re Eletrobras Sec. Litig., 245 F. Supp. 3d 450 (S.D.N.Y. 2017).*}

[3] *Das v. Rio Tinto PLC,* 332 F. Supp. 3d 786 (S.D.N.Y 2018).

[4] *In re Braskem S.A. Sec. Litig.*, 246 F. Supp. 3d 731 (S.D.N.Y. 2017).

[5] *Menaldi v. Och-Ziff Capital Mgmt. Grp. LLC, 277 F.Supp.3d 500 (S.D.N.Y. 2017).*

[6] *See, eg, Shields on Behalf of Sundstrand Corp. v. Erickson*, 710 F.Supp. 686, 691 (1989).

[7] *See*, *eg*, *Morefield v. Bailey,* 959 F. Supp. 2d 887, 906 (E.D. Va. 2013).

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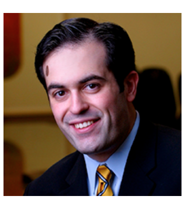

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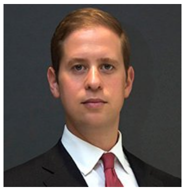

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