Another Reason to Fear the Foreign Corruption Practices Act – The Private Tag-Along Suit

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Halliburton

In February, Halliburton's former subsidiary, KBR, admitted paying Nigerian officials at least $182 million in bribes to secure contracts to build liquefied natural gas facilities in Nigeria. KBR pleaded guilty to violating the Foreign Corrupt Practices Act (FCPA), 15 U.S.C. § 78dd-1 *et seq.*, and agreed to pay a $402 million criminal fine, the second largest criminal FCPA fine. At the same time, Halliburton agreed to settle civil FCPA charges by paying $177 million in disgorgement for failing to prevent the bribery and for falsifying records.

The settlements with U.S. regulators, however, did not end the companies' time in court. In May, a City of Detroit pension fund that held Halliburton shares brought a shareholder derivative action in Texas state court against Halliburton, KBR and many of the directors and officers. The complaint alleged the defendants breached their fiduciary duties through "their reckless failure to monitor the Companies' internal controls." Although the sprawling complaint cites a "laundry list of misdeeds" – including allegations of overcharging the U.S. government, human trafficking, and doing business with Iran – much of the complaint piggybacks on the facts concerning the Nigerian bribery brought to light by the earlier FCPA settlement.

As the number of FCPA enforcement actions increase, facts brought to light through an FCPA investigation are bound to produce more private tag-along suits such as this. These tag-along suits can take many forms. In particular, class action securities fraud suits and derivative fiduciary duty suits are increasingly becoming the expected corollary to a major FCPA investigation.

FCPA

The FCPA contains two main components: (1) the anti-bribery provisions make it illegal to offer or provide money or anything of value to foreign officials in order to obtain or retain business; and (2) the accounting provisions require accurate books-and-records as well as internal controls to prevent FCPA violations. The U.S. Securities and Exchange Commission (SEC) and the U.S. Department of Justice

(DOJ) share responsibility for enforcing the FCPA. The SEC and DOJ vigorously investigate potential violators with any connection to U.S. securities markets. Domestic companies can be liable for the actions of their foreign affiliates. Foreign companies that trade on U.S. securities markets are also covered by the FCPA.

Enforcement of the FCPA has exploded in recent years. Both the number of investigations and the size of resulting fines have ballooned. The fines have been staggering. In December of 2008, Siemens agreed to pay $800 million in fines and penalties related to FCPA violations.

There is every reason to believe even more companies will be the subject of investigations, or will self-disclose their FCPA violations. Both the DOJ and the SEC have increased their FCPA staffing. The Sarbanes-Oxley Act, Pub.L. 107–204, 116 Stat. 745 (July 30, 2002), has increased the incentive to self-disclose corruption issues. Finally, many companies now voluntary disclosure their FCPA violations to regulators in an effort to reduce the resulting fines.

Tag-Along Litigation

FCPA fines and settlements with regulators, however, may not be the end of litigation for companies caught up in corruption scandals. The FCPA contains no private right of action; only the DOJ and SEC can directly pursue an FCPA claim. Increasingly, however, facts brought to light through an FCPA investigation have given rise to a succession of tag-along lawsuits by private litigants based on other legal theories.

Some types of tag-along lawsuits are driven by the particular circumstances and parties involved. For example, a losing bidder for a government contract might bring an action against the company that paid a bribe to obtain the contract. In addition, a foreign government whose official received the bribe might actually sue the company whose employee provided the bribe. Last year, Iraq brought a federal suit in New York against 91 companies and 2 individuals alleging that they conspired with Saddam Hussein's regime to corrupt the Oil-for-Food program *The Republic of Iraq v. ABB, et al*. No. 08-cv-05951 (S.D.N.Y. 2008). Similarly, Bahrain's state-owned aluminum smelter, Alba, commenced a federal action in Pittsburgh against its supplier, Alcoa, alleging Alcoa and its affiliates bribed Alba's senior officials, thereby causing Alba to pay inflated prices.

FCPA violations can also lead to lawsuits brought by business partners. International business contracts increasingly contain representations and other clauses concerning FCPA compliance, thus creating situations where a non-corrupt partner may seek to terminate a business arrangement on the basis of his partner's FCPA violation.

The most common tag-along claims, however, are class action and derivative lawsuits. The class actions are typically cast as securities claims by shareholders under Rule 10(b) and based on allegations that the company failed to disclose its corruption deficiencies. In the derivative suits, brought by shareholders on behalf of the company, the argument is typically that the company was harmed because the directors and officers violated their fiduciary duty by permitting the corruption. Many of these class action and derivative claims are now being brought by sophisticated plaintiffs' securities class action firms.

Tag-along class action or derivative suits have followed a number of recent high-profile FCPA investigations, including cases against Siemens, Baker Hughes, Chevron, BAE, Willbros, Immucor, Nature's Sunshine, FARO Technologies and AWB. Many of the suits have settled for substantial sums. Willbros paid $10.5 million to settle a class action suit alleging the company had to restate several years of financial statements and establish a reserve for possible fines and penalties for FCPA violations. Immucor paid $2.5 million to settle an action alleging the company and some of its directors and officers misled investors concerning the extent of the company's corrupt business practices and the strength of its internal controls.

Defendants in these tag-along suits have raised a number of defenses – from arguing that U.S. courts lack jurisdiction over foreign players and that more lenient foreign law ought to apply to the actions of foreign entities to arguing that the defendants lack the required knowledge of wrongdoing necessary to establish securities fraud. Last year, the U.S. Court of Appeals for the Ninth Circuit dismissed a securities fraud complaint that piggybacked on FCPA disclosures made by InVision concerning illegal payments to foreign sales agents in Asia *Glazer Capital Mgmt. LP v. Magistri*, 549 F.3d 736 (9th Cir. 2008). The court reasoned that although the company admitted in its FCPA settlement that it "improperly accounted for certain payments . . . in its books and records in violation of the FCPA," the plaintiffs had not made the required showing that the employees that made public disclosures concerning the company's compliance measures knew about the FCPA violations.

Planning For The Tag-Along Suit

These tag-along suits are sure to multiply. Companies and their attorneys need to begin planning for these suits at all stages of their anti-corruption work – from how they establish their anti-corruption protocols, to how they investigate possible FCPA violations, to how they respond to FCPA investigations, and finally, to how they negotiate settlements with regulators.

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