MATERIALITY AND FCPA DISCLOSURES

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When does a public company have to disclose a government investigation or inquiry of a potential FCPA violation? Like many other FCPA issues – there is no clear cut answer. We are back to Justice Potter Stewart's solution – "I know it when I see it."

It seems that some companies have blinders on when it comes to resolving this issue. From what I can tell, companies come up with different answers when deciding when they have to disclose an FCPA investigation.

The implications of a failure to disclose are significant. Every lawyer claims to know the answer to the question of when to disclose, they fake it – "if it is a material event." And, of course, "materiality" depends on the eye of the beholder.

What exactly makes an event material varies from case to case. Let's start with the basic framework.

Federal securities law requires publicly traded companies to report "material" risks and events — that is, information that the average investor would want to know before making an investment decision. Public companies are subject to explicit disclosure and reporting requirements under the Securities Exchange Act of 1934, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K when specified events occur and can be used to satisfy other disclosure obligations of public companies.

A materiality analysis requires both a ***quantitative*** analysis (e.g. the approximate dollar amount of revenues, assets and liabilities associated with the violation and the potential impact of the violation) and a ***qualitative*** analysis which turns on what a reasonable investor would find important in making an investment decision, including the potential impact of corporate activities upon the company's reputation and share value. For example, under the "qualitative materiality" standard set forth the SEC's 1999 Staff Accounting Bulletin No. 99, violations of the FCPA, especially egregious ones, could be considered "material" for purposes of the Securities and Exchange Act disclosure requirements, even if they involve relatively insignificant monetary sums (and therefore do not rise to a quantitative level of materiality). Companies that report FCPA violation in their quarterly or annual reports simultaneously will disclose the potential violations to the SEC and Justice Department.

The Sarbanes-Oxley reforms have increased corporate detection of FCPA violations and the number of FCPA disclosures. SOX requires CEOs and CFOs to certify both that the company's financials are truthful and accurate and that they are personally responsible for the company's internal controls. They are also obligated to report to the auditors and Board of Directors any significant deficiencies in the internal controls, and are subject to criminal penalties for a willful failure to comply with these responsibilities.

Adding to the pressure to disclose is the possibility of a shareholder suit for failing to disclose FCPA violations, as well as the complication of Dodd-Frank and SOX whistleblower protections. If there is any hint of retaliation or adverse response to a whistleblower, the company may be forced to pay the whistleblower compensatory and special damages as well as attorneys' fees.

The risks of failing to disclose are very real – private and class action cases against companies are likely to be filed. Officers and directors are individually responsible to disclose FCPA violations. If an officer or director has knowledge of an investigation, he or she cannot simply rely on the company's disclosure procedures but must inquire of counsel whether such an investigation should be disclosed in the company's filings. Some counsel have taken the position that even a immaterial investigation or inquiry should be disclosed in order to reduce the company's exposure to private litigation liability. That may be a little harder to justify since a public announcement will inevitably result in adverse publicity and negatively impact the stock price, and attract attention by the plaintiff's bar.