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Does that settle it? Well, maybe not

Companies should be aware of ancillary remedies and collateral consequences in FCPA settlements with the SEC.

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As the fervor to prosecute corruption continues to spread globally, factors involved in investigating, remediating and settling the matters are increasingly complex. Many assume that once the broad terms of settlement are reached with the regulator, finally the long travail is over. Unfortunately, this is wrong. When the costly, disruptive investigation phase ends and the finish line is near, corporate entities settling Foreign Corrupt Practices Act violations with the U.S. Securities and Exchange Commission should consider the possible ancillary remedies and collateral consequences of the settlement.

This article provides an overview of FCPA settlement forms, the ancillary remedies most frequently pursued by the SEC and settlement effects on affiliates of settling companies. Identifying potential ancillary remedies and collateral consequences early in the investigation and settlement stages is essential to ensuring that settlement terms are favorable to not only the settling party, but also to its affiliates.

There are four main settlement forms: civil injunction; cease-and-desist order; deferred-prosecution agreement; and nonprosecution agreement.

The civil injunction and the cease-and-desist order are similar in that the settling entity neither admits nor denies the SEC's allegations and is ordered to refrain from future securities laws violations. Settlement through a civil injunction requires the SEC to demonstrate to a federal court that the settling entity has violated or is about to violate the securities laws. See John H. Sturc et al., SEC Investigations and Enforcement Actions, in Securities Litigation: A Practitioner's Guide 15-14, 15-20 (Jonathan Dickey ed., 2011). The relevant settlement documents are the SEC's complaint, containing the allegations against the defendant; the consent, by which the defendant agrees to the entry of the final judgment without admitting or denying the allegations; and the final judgment approved by the court, which orders the injunction and imposes sanctions but does not include any findings of fact or conclusions of law.

Settlement through a cease-and-desist order, on the other hand, does not require adjudication in federal court. Rather, the cease-and-desist proceeding takes place before an administrative law judge, who is a full-time SEC employee, with a right of appeal to the SEC, and from there, to a U.S. court of appeals. Sturc et al., supra, at 15-25. The cease-and-desist settlement document is the order instituting administrative cease-and-desist proceedings, which includes factual findings, violations of law and agreed-upon sanctions.

The SEC has settled roughly twice as many FCPA cases with corporate entities through civil injunctions as compared with cease-and-desist orders. Since 2000, the SEC has entered into 25 FCPA cease-and-desist orders, whereas it has settled 45 FCPA cases on an injunctive basis.

THE NEW SETTLEMENT FORMS

At the beginning of 2010, the SEC announced the availability of nonprosecution agreements and deferred-prosecution agreements as settlement forms, but it has used each of these means only once since then. "SEC Charges Former Carter's Executive with Fraud and Insider Trading," SEC Rel. No. 2010-251 (Dec. 20, 2010); "Tenaris to Pay $5.4 Million in SEC's First-Ever Deferred Prosecution Agreement," SEC Rel. No. 2011-112 (May 17, 2011). In a deferred-prosecution agreement, the SEC forgoes enforcement action in exchange for cooperation, a tolling agreement, compliance with certain undertakings and an agreement either to admit or not contest facts the SEC could assert to establish a violation of securities laws. SEC Enf. Manual § 6.2.3 (2012). In a nonprosecution agreement, the SEC agrees not to pursue an enforcement action in exchange for cooperation and compliance with certain undertakings. Id. § 6.2.4.

The SEC may seek ancillary remedies, which include disgorgement (plus prejudgment interest) and civil monetary penalties, the extent of which is dependent in part upon the settling party's demonstrated cooperation. 17 C.F.R. 201.600 (2011); see Sturc et al., supra, at 15-15; see also SEC Enf. Manual, supra, § 6.1.2. In the 45 FCPA civil injunction settlements since 2000, 40 included disgorgement, ranging from $1,041,112 to $350 million. ITT Corp., Lit. Rel. No. 20896 (Feb. 11, 2009); Siemens A.G., Lit. Rel. No. 20829 (Dec. 15, 2008). In comparison, out of the 25 FCPA cease-and-desist settlements since 2000, only 10 included disgorgement, ranging from a low of $259,000 to a high of $11,306,081. Westinghouse Air Brake Technologies Corp., Acct. & Aud. Enf. Rel. No. 2785 (Feb. 14, 2008); Watts Water Technologies Inc., Acct. & Aud. Enf. Rel. No. 65555 (Oct. 13, 2011).

Beware of prejudgment interest: It can add a significant additional sum to the settlement amount, especially when the interest is measured from dates long in the past when the corrupt conduct is alleged to have begun. See, e.g., SEC v. Smith & Nephew, Lit. Rel. No. 22252 (Feb. 6, 2012) (prejudgment interest representing 35 percent of disgorgement figure); SEC v. Aon Corp., Lit. Rel. No. 22203 (Dec. 20, 2011) (prejudgment interest representing 27 percent of disgorgement figure).

When settling on either an injunctive or cease-and-desist basis, the SEC may assess civil monetary penalties from issuers and from persons associated with issuers. 15 U.S.C. 77u(d)(3)(A), 78u-2(a)(2) (2006). The calculation structures are identical, and the penalty amounts are calculated based upon the severity of the violation and whether the defendant is an individual or a corporate entity. Id. §§ 78u(d)(3)(B), 78u-2(b). Civil monetary penalties in FCPA cases have ranged from $217,000 to $16,510,000 in civil injunctive settlements, and from $65,000 to $3,000,000 in cease-and-desist settlements. Tidewater Inc., Lit. Rel. No. 21729 (Nov. 4, 2010); ABB Inc., Lit. Rel. No. 18775 (July 6, 2004);

Natco Group Inc., Acct. & Aud. Enf. Rel. No. 3101 (Jan. 11, 2010); Dynegy Inc., Lit. Rel. No. 17744 (Sept. 25, 2002).

OBLIGATIONS AND RISKS

The following is a nonexhaustive list of the most common disclosure obligations and disqualification risks for corporate entities and their affiliates when settling FCPA actions on a civil injunctive or cease-and-desist basis. (For an in-depth analysis of collateral consequences, see Carmen Lawrence et al., "Seeing Beyond the Deal: The Collateral Consequences of SEC Settlements," The Investment Law., Nov. 2011).

The entry of both a civil injunction and a cease-and-desist order against a public company, including its subsidiaries, requires disclosure in the company's public filings with the SEC. See 17 C.F.R. 229 (2011). Specifically, disclosure is required of "any material pending legal proceedings" in which the public company or any of its subsidiaries is a party. This disclosure must be made in reports filed with the SEC, including registration statements, annual reports, proxy statements, going-private transaction statements, Schedule 13D reports, and tender-offer statements. If disgorgement or civil monetary penalties are ordered, additional financial disclosures may be required by Financial Standard No. 5. See Brian A. Ochs et al., The Securities Enforcement Manual: Tactics & Strategies 231-32 (Michael J. Missal & Richard M. Phillips, eds. 2d ed. 2007). Investment companies must also disclose "legal proceedings instituted, or known to be contemplated, by a governmental authority." 17 C.F.R. 239.15, 274.11A (2011).

Registered investment advisers must promptly disclose on Form ADV the disciplinary history of the adviser and its "advisory affiliates," defined as all persons directly or indirectly controlling the adviser. See Form ADV Part 1A. In the case of registered broker-dealers, Form BD requires this same type of disclosure of disciplinary proceedings of the broker-dealer and its "control affiliates," which includes any entity or person that directly or indirectly controls, is under common control with, or is controlled by, the broker-dealer. Forms ADV and BD both require disclosure of circumstances in which the SEC has "found" that the relevant entity (or its affiliates) violated SEC regulations and statutes through "adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings." Finally, both forms require disclosure when the SEC has ordered the relevant entity or its advisory affiliates to cease and desist from any activity or has imposed a civil monetary penalty. Whether to disclose under these requirements often is a difficult calculus that is best made with advice from counsel experienced in making these calls.

The Investment Company Act makes it unlawful for a company that is enjoined from any misconduct in connection with the purchase or sale of securities to serve as an investment adviser for any registered investment company. 15 U.S.C. 80a-9 (2006). This disqualification applies to a company that has any affiliates — broadly defined as companies or persons that are "directly or indirectly controlling, controlled by, or under common control with" the relevant entity — that fall under § 9(a) of the act. Id. §§ 80a-9, 80a-2. However, an exemption from the disqualification can be obtained by application to the SEC, which must be granted if it is established that the disqualification is "unduly or disproportionately severe" or that granting it would not be against the public interest or contrary to the protection of investors. Id. § 80a-9.

The injunction settlement also presents the risk of losing the protections of § 25A of the Securities Act and § 21E of the Exchange Act, which provide public companies with safe harbors from liability for certain forward-looking statements when those statements are questioned in private securities actions. Id. §§ 77z-2(b), 78u-5(b). The statutory safe harbors are unavailable for three years to an issuer who is the subject of an injunction or cease-and-desist order for violations of the anti-fraud provisions of the securities laws. However, settling defendants may seek an exemption from this disqualification through application to the SEC.

Another disqualification risk is a proposed SEC rule under the Dodd-Frank Wall Street Reform and Consumer Protection Act, passed on July 15, 2010, which could prohibit a party related to the settling entity from availing itself of the private-placement exemption of Rule 506 of Regulation D, the most common rule used to sell securities in a private placement exempt from the Securities Act. Counsel should seek a waiver of this disqualification in any settlement.

Because deferred-prosecution agreements and nonprosecution agreements are of such recent origin, it remains to be seen what collateral consequences may arise from them. However, commentators have suggested that because both kinds of settlements are not actually enforcement actions, a public company that settles through a deferred-prosecution agreement and nonprosecution agreement may be able to avoid the disclosure obligations and statutory disqualifications discussed above. See, e.g., Joseph Jeremy et al., "The SEC Uses an FCPA Case for Its First-Ever Deferred Prosecution Agreement," Gibson Dunn Publications, May 19, 2011; Bruce A. Hilner et al., "SEC's First Use of a Non-Prosecution Agreement Shows Potential Benefits for Respondents but Also Demonstrates Potential Pitfalls," Clients & Friends Memo, Jan. 10, 2011.

Whereas the above discussion of common examples of remedies and collateral consequences provides an overview for issue-spotting purposes when settling FCPA cases with the SEC, it is not all-inclusive. Well before the settlement negotiation phase begins, experienced counsel should identify strategies and arguments for limiting the ancillary remedies the SEC may pursue, and counsel should coordinate with the client to recognize potential liabilities arising from settlement that could affect the client's affiliates. Further, counsel should apply for disqualification waivers or exemptions from the SEC while settlement negotiations continue on a parallel track. With proper preparation and planning, counsel and the client can effectively negotiate the ancillary remedies and collateral consequences of the FCPA settlement

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