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Privileged and Work Product Documents from Investigations Now at Risk: How the *Wal-Mart* Ruling Increases the Risk Shareholders Will Pursue Documents from FCPA Internal Investigations

The Delaware Supreme Court recently ordered Wal-Mart Stores, Inc. ("Wal-Mart") to provide a stockholder with documents relating to its initial internal investigation into allegations of bribery of foreign officials at its Mexican operations. The far-reaching order in *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*[1] not only found that the conduct of Wal-Mart's internal investigation was fair game for a record request by shareholders, but also that privileged documents and work product from the investigation should be produced. Shareholder plaintiffs and their counsel are sure to try to leverage the *Wal-Mart* ruling into a broader opportunity to obtain documents from other internal investigations.

A key to the *Wal-Mart* ruling was the Supreme Court's endorsement of a Delaware Chancery Court's finding that there was a "colorable basis" for believing that "part of the wrongdoing was in the way the investigation itself was conducted."[2] The Supreme Court concluded that investigating such potential wrongdoing was not only a "proper purpose" for making a demand for documents under Section 220 of the Delaware General Corporation Law ("DGCL"),[3] but also that it (*i*) made the production of investigative records "necessary and essential" to fulfilling that proper purpose; (*ii*) constituted

CONTINUED ON PAGE 2

1. No. 614, 2013, 2014 WL 3638848 (Del. July 23, 2014) ("*Wal-Mart*").
2. *Wal-Mart,* 2014 WL 3638848 at *12.
3. Del. Code Ann. Tit. 8, § 220.

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Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 1

"good cause" for the disclosure of privileged documents under the standard set forth in the Fifth Circuit's seminal decision in *Garner v. Wolfinbarger*;[4] and (*iii*) provided a basis for ordering the production of documents otherwise protected by the work product doctrine.

In the wake of *Wal-Mart*, stockholders in future cases are likely to raise questions about the ways in which investigations have been conducted to see whether those questions also provide a "colorable basis" for seeking a broad range of investigative records. Companies that conduct investigations, therefore, will want to structure the investigation from the outset in a way that limits the ability of shareholders to assert that it was done improperly or otherwise may give rise to any legitimate shareholder concern. This, in turn, will place a premium on early decisions about who should conduct the review, who should supervise the review and the scope of the inquiry. Those decisions, which are generally made before any review has been conducted and based upon limited information, are sure to get close scrutiny from stockholders and should be undertaken with the utmost deliberation and care.

I. *The New York Times* Article about Wal-Mart's Early Investigation of Potential Bribery and the Resulting Stockholder Inspection Demand

On April 21, 2012, *The New York Times* published an article raising questions about the way in which Wal-Mart had conducted a 2005 and 2006 investigation of bribery allegations at Wal-Mart's Mexican subsidiary, WalMex.[5] According to *The New York Times* article, when allegations of potential bribery were raised by a former Wal-Mart employee in Mexico, Wal-Mart dispatched an internal team of investigators from corporate headquarters that found $24 million in suspicious payments and evidence that the payments were known to senior executives at WalMex. *The New York Times* claimed that the initial report concluded that "[t]here is reasonable suspicion to believe that Mexican and USA laws have been violated." The authors of the initial report, *The New York Times* reported, had recommended a deeper investigation using private investigators.

That recommendation was never followed, according to *The New York Times* article. Instead, a further review was undertaken by the General Counsel of WalMex – a person *The New York Times* article described as "evasive" and "hostil[e]" towards the initial investigators of the issues. Several weeks after initiating the follow-up investigation, the General Counsel issued a six-page report finding "no evidence or clear indication of bribes paid to Mexican government authorities." After a preliminary draft of the report was presented to executives at Wal-Mart headquarters, *The New York Times* said, the General Counsel was asked to put his report into final form, and the case was closed.

On June 6, 2012, less than two months after *The New York Times* article, the Indiana Electrical Workers Pension Trust Fund IBEW ("IBEW"), a Wal-Mart stockholder, sent a letter to Wal-Mart seeking to inspect documents under Section 220 of the DGCL (the "Demand"). The Demand cited three purposes, "to investigate: (1) mismanagement in connection with the WalMex [a]llegations [described in *The New York Times* article];

CONTINUED ON PAGE 3

4. 430 F.2d 1093 (5th Cir. 1970).

5. David Barstow, "Wal-Mart Hushed Up a Vast Mexican Bribery Case," *The New York Times* (Apr. 21, 2012), http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html.

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Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 2

(2) the possibility of breaches of fiduciary duty by Wal-Mart or WalMex executives in connection with bribery allegations; and (3) whether a pre-suit demand on the board would be futile as part of a derivative suit."[6]

In response, Wal-Mart produced 3,000 documents covering FCPA compliance policies, Board and Audit Committee materials related to the WalMex allegations and Board and Audit Committee materials related to FCPA compliance policies.[7] IBEW responded on August 13, 2012 by filing a complaint in the Delaware Chancery Court seeking a more extensive production in response to the demand.[8]

II. Section 220 Provides Stockholders the Opportunity to Inspect Corporate Books and Records, Including, in Some Cases, Privileged Documents[9]

Under Delaware's Section 220, a stockholder is permitted, upon written demand under oath, to "inspect for any proper purpose" the "books and records" of a company.[10] Section 220 codifies and expands on the well-established common law right of stockholders to inspect the books and records of the corporation. That right arises from the proposition that as part owner, the stockholder is entitled to know how his or her agents are managing the business.[11] Section 220 provides stockholders with a means to access documents of the corporation that are necessary to make informed decisions and to protect their interests as stockholders.

> "A stockholder's right to access documents, however, is not unlimited. The interests of the stockholders must be carefully balanced against the legitimate interests of the corporation. Section 220 is not an invitation to a 'fishing expedition'; nor will inspection be granted for speculative purposes or to satisfy 'idle curiosity.'"

Delaware courts recognize the statutory inspection right as an important information-gathering tool and encourage potential plaintiffs to use the "tools at hand" before pursuing litigation.[12] A stockholder's right to access documents, however, is not unlimited. The interests of the stockholders must be carefully balanced against the legitimate interests of the corporation. Section 220 is not an invitation to a "fishing expedition"; nor will inspection be granted for speculative purposes or to satisfy "idle curiosity."[13]

To properly exercise a Section 220 demand for inspection, the stockholder must (*i*) comply with the procedural requirements of the statute, (*ii*) prove a proper purpose for the inspection, and (*iii*) narrowly tailor the request to only those documents that are essential to accomplishing the asserted purpose.

A. Inspection Normally Limited to a "Proper Purpose"

The propriety of a stockholder's stated purpose is "paramount" to determining whether a stockholder is entitled to inspection.[14] Section 220 defines a proper purpose as one that is "reasonably related to such person's interest as a stockholder."[15] Delaware case law has recognized that a stockholder has a proper purpose to investigate corporate wrongdoing including waste, mismanagement, self-dealing or other breaches of fiduciary duty.[16] This is the most commonly alleged proper purpose under Section 220. Where the stockholder's stated purpose is to investigate wrongdoing,

CONTINUED ON PAGE 4

6. *Wal-Mart,* 2014 WL 3638848 at *2.
7. *Id.* at *3.
8. *Id.*
9. Those already familiar with the requirements of Section 220 and *Garner v. Wolfinbarger* may wish to go directly to Section III, below.
10. Del. Code Ann. Tit. 8, § 220(b).
11. *Guthrie v. Hawkins*, 199 U.S. 148, 153-55 (1905); *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 116 (Del. 2002).
12. *See Saito,* 806 A.2d at 115; *Sec. First Corp. v. U.S. Die Casting & Dev. Co.,* 687 A.2d 563, 567 n.3 (Del. 1997); *Grimes v. Donald*, 673 A.2d 1207, 1216-17 (Del. 1996).
13. *Sec. First Corp.*, 687 A.2d at 565; *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 467 (Del. 1995).
14. *CM&M Group, Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982).
15. Del. Code Ann. Tit. 8, § 220(b).
16. *Seinfeld v. Verizon Commc'n Inc.*, 909 A.2d 117, 121-22 (Del. 2006); *Thomas & Betts Corp. v. Leviton Manuf. Co.*, 681 A.2d 1026, 1031 (Del. 1996).

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 3

he must establish a credible basis to infer that waste or mismanagement may have occurred.[17] However, because a Section 220 action is not a full trial on the merits, the stockholder need not prove actual wrongdoing by a preponderance of the evidence. The credible basis threshold is satisfied by a showing through documents, logic, testimony, or otherwise that there are legitimate issues of wrongdoing.[18]

> "In a Section 220 action, the scope of permitted inspection is much narrower than discovery permitted in civil lawsuits. The stockholder bears the burden of showing that each category of books and records requested is necessary and essential to accomplish a proper purpose."

Delaware cases also recognize a variety of additional proper purposes for a Section 220 demand, including (among others) to uncover the facts necessary to plead demand futility with particularity[19] and to determine the independence of a special committee and whether the board complied with Delaware law in refusing a litigation demand.

B. Inspection Normally Limited to "Necessary and Essential" Documents

Once a stockholder has established that he or she is entitled to a Section 220 inspection, the court's analysis shifts to determining the appropriate scope of inspection. In a Section 220 action, the scope of permitted inspection is much narrower than discovery permitted in civil lawsuits. The stockholder bears the burden of showing that each category of books and records requested is necessary and essential to accomplish a proper purpose.[20] Generally speaking, a document is essential for Section 220 purposes if it addresses the "crux" of the stated purpose and if the information in the document is unavailable from another source.[21]

A trial court's order granting inspection of corporate books and records must be circumscribed "with rifled precision."[22] Nevertheless, the "rifled precision" requirement should not prevent a stockholder who demands inspection for a proper purpose from accessing all of the documents in the corporation's possession, custody, or control that are necessary to satisfy that proper purpose.[23] Importantly, the Court of Chancery is also charged with a duty to safeguard the rights of the corporation: "[t]he Court of Chancery is empowered to protect the corporation's legitimate interests and to prevent possible abuse of the shareholder's right of inspection by placing such reasonable restrictions and limitations as it deems proper on the exercise of the right."[24] Achieving a proper balance between these competing interests is critical to determining the scope of inspection.

C. Inspection Normally Limited by Attorney-Client Privilege and Work Product Immunity

Normally, the attorney-client privilege and work product immunity apply in the context of a stockholder demand, and documents may be withheld from inspection on that basis. The U.S. Court of Appeals for the Fifth Circuit, however, long ago recognized an exception to the attorney-client privilege that could arise in the context of a stockholder claim. In *Garner v. Wolfinbarger*, the court ruled that "where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance."[25] Under this standard, the *Garner* court said that "good cause" for overcoming the

CONTINUED ON PAGE 5

17. *Thomas & Betts Corp.*, 681 A.2d at 1031.
18. *Sec. First Corp.*, 687 A.2d at 568.
19. *Grimes*, 673 A.2d at 1216-17.
20. *Sec. First Corp.*, 687 A.2d at 569.
21. *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 371-72 (Del. 2011).
22. *Id.* at 372 (citing *Sec. First Corp.*, 687 A.2d at 569-70).
23. *Saito*, 806 A.2d at 115.
24. *CM&M Group, Inc.*, 453 A.2d at 793-94; *see also* Del. Code. Ann. Tit. 8, § 220(c) (granting court discretion to place limitations or conditions on books and records to be made available for inspection).
25. *Garner*, 430 F.2d at 1103-04.

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 4

privilege could be based upon a variety of factors, including "the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources."[26]

Before *Wal-Mart*, the Delaware Supreme Court had never explicitly endorsed *Garner* as a correct interpretation of Delaware law, although the Chancery Court had looked to the case on several occasions to determine in derivative actions whether the privilege should prevent disclosure to stockholders.[27] In relying on *Garner*, the Chancery Court had generally focused on "(*i*) whether [the stockholder] claim is colorable; (*ii*) [the] necessity or desirability of information and its availability from other sources; and (*iii*) [the] extent to which information sought is identified as opposed to blind fishing expedition."[28]

Historically, *Garner* has been applied solely to the attorney-client privilege and not to work-product immunity. Under Delaware Court of Chancery Rule 26(b)(3), however, work product immunity also can be overcome where a claimant can show "substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means." Although the 26(b)(3) requirements are close to *Garner's* oft-cited necessity and availability factor, the *Garner* standard normally has been applied separately from the work-product analysis.

"Historically, *Garner* has been applied solely to the attorney-client privilege and not to work-product immunity."

III. Proceedings in the Delaware Chancery Court

As frequently happens in disputes over Section 220 demands, the Chancery Court ordered a trial to be conducted on the basis of a written record. The trial took place on May 20, 2013 and essentially took the form of oral argument based upon the submitted record. The trial focused on the scope of the stockholder's requests; the extent of the effort undertaken by Wal-Mart to produce documents; and the applicability of the attorney-client privilege and attorney work product immunity to the stockholder requests.[29] Chancellor Leo Strine, who has since become Chief Justice of the Delaware Supreme Court, ruled that "core information regarding the WalMex bribery, construction-permitting situation and how [the initial investigation] was handled within Wal-Mart by high-level officers and directors" was "central to the [stockholder's] request" and was necessary and essential to a proper purpose.[30] Chancellor Strine added that "there's a colorable basis that part of the wrongdoing was in the way the investigation itself was conducted" and, as a result, the stockholder should be given access to privileged documents and attorney work product, because "it's very difficult to find those documents [*i.e.*, evidence of such wrongdoing] by other means."[31]

Based upon this ruling at trial, Chancellor Strine entered a final judgment on October 15, 2013, ordering Wal-Mart to produce data from certain specified sources, including specific individual officers of Wal-Mart and data not only from live servers, but also from certain back-up tapes and handheld devices; review all data from

CONTINUED ON PAGE 6

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26. *Id.* at 1104. Other factors cited by the *Garner* court included:
> the number of shareholders and the percentage of stock they represent; the bona fides of the shareholders; the nature of the shareholders' claim and whether it is obviously colorable; . . . whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality; whether the communication related to past or to prospective actions; whether the communication is of advice concerning the litigation itself; the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.
>
> *Id.*

27. *See, e.g.*, *Grimes v. DSC Communications Corp.*, 724 A.2d 561, 568 (Del. 1998).

28. *Id.* (quoting *Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc.,* No 8853, 1987 WL 12500 (Del. Ch. June 19, 1987)).

29. *See generally* Trial Transcript and Rulings of the Court, *Indiana Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, Civ. Action No. 7779-CS 2013 WL 3818580 (Del. Ch. May 20, 2013) ("Trial Tr.").

30. *Id.* at 29-30.

31. *Id.* at 31-32.

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 5

12 specific individuals for responsiveness; and produce certain documents previously identified on a privilege log as attorney-client privileged or attorney work product.[32] As summarized by the Supreme Court, the Chancery Court order encompassed "officer (and lower)-level documents regardless of whether they were ever provided to Wal-Mart's Board of Directors or any committee thereof; [. . .] documents spanning a seven-year period and extending well after the timeframe at issue" and "contents of Responsive Documents that are protected by the attorney-client privilege . . . and the contents that are protected by the attorney work-product doctrine under Court of Chancery Rule 26(b)(3)."[33]

IV. Wal-Mart's Appeal to Delaware Supreme Court

Wal-Mart appealed the Chancery Court's judgment to the Delaware Supreme Court, claiming that the scope of production was overbroad and the requirement to produce privileged documents and work product was unfounded.[34]

A. Scope of Production

Wal-Mart's first challenge was to the lower court's decision "requiring it to 'produce documents that were never presented or created by members of [Wal-Mart's] Board of Directors.'"[35] Wal-Mart argued that the proper purpose of the inspection was to determine whether demand on the current board would be futile and that the Chancery Court's ruling, which included ordering access to documents that went only to non-director senior executives, was overly broad.

The Supreme Court acknowledged the Chancery Court's view that the purpose of the inspection demand "was primarily to look for facts to determine whether demand is, in fact, excused," but added that the purpose to investigate the underlying bribery and how the initial investigation was handled also constituted proper purposes for an inspection demand. To be sure, Chancellor Strine said in his ruling that the documents he ordered produced all related to whether the stockholders could "plead and get demand excusal,"[36] drawing a link between the "core information" about the underlying bribery and initial investigation, on the one hand, and how that information was handled by Wal-Mart's directors and senior officers, on the other hand.[37] The Supreme Court also highlighted the importance of this "core information" to the stockholder's case, but unlike Chancellor Strine, the Supreme Court elided the connection between that core information and demand excusal. As a result, it is somewhat unclear whether the Supreme Court found the stockholders' interest in the underlying bribery and the initial investigation were subsidiary to the proper purpose of determining the demand excusal issue, as Chancellor Strine seemed to suggest, or whether the issues of the underlying bribery and initial investigation were themselves distinct and independent proper purposes for the stockholder's inspection demands.

In affirming the scope of Chancellor Strine's order, the Supreme Court also determined that the production of documents related to the knowledge of non-director officers of the Company was required because the stockholder "may establish director knowledge of the WalMex Investigation by establishing that certain Wal-Mart officers were in a 'reporting relationship' to Wal-Mart directors, that those officers did in fact report to specific directors, and that those officers received key information regarding the WalMex Investigation."[38] Overruling Wal-Mart's objection that information known only to officers could not be relevant to what Wal-Mart's directors did or did not know unless there was evidence of communication from the officers to the directors, the Supreme Court held that the Chancery Court "properly exercised its discretion" when it found that a "reasonable inference . . . would be that those officers passed the information on to the directors."[39]

CONTINUED ON PAGE 7

32. Final Order and Judgment, *Indiana Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.,* No. 7779-CS, 2013 WL 5636296 (Del. Ch. Oct. 15, 2013).
33. *Wal-Mart,* 2014 WL 3638848 at *4.
34. IBEW cross-appealed, arguing that the Chancery Court's order did not go far enough, because it did not require Wal-Mart to correct deficiencies in prior productions and also ordered IBEW to return documents it obtained from an anonymous source. *Id.* at *1. The Supreme Court ultimately rejected both aspects of the cross appeal. *Id.* at *14-15.
35. *Id.* at *6 (quoting Wal-Mart's brief).
36. Trial Tr. at 30.
37. *Id.* at 29-30.
38. *Wal-Mart,* 2014 WL 3638848 at *7.
39. *Id. at* *7.

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 6

B. Privileged Documents

Wal-Mart's second challenge was to the Chancery Court's order that documents subject to the attorney-client privilege and work product immunity also should be produced for inspection. With respect to attorney-client privilege documents, Wal-Mart had argued that the Delaware Supreme Court had never endorsed the Fifth Circuit's opinion as the law of Delaware and, in any event, that the doctrine should not apply in the context of a Section 220 demand. The Supreme Court dispatched both arguments, noting that it tacitly had endorsed *Garner* in two prior cases and that the Chancery Court had expressly adopted it many times, including in the Section 220 context.[40] As a result, the Supreme Court expressly said that *Garner* "applied in plenary stockholder/corporation proceedings" and was applicable in Section 220 actions so long as the "necessary and essential inquiry . . . precede[d] any privilege inquiry."[41]

The Supreme Court then applied the *Garner* standard to the inspection demand made by IBEW, concluding that the facts identified by the Chancery Court warranted a finding of "good cause" for overcoming the attorney-client privilege. The Supreme Court recognized that application of *Garner* should be "narrow, exacting, and . . . very difficult to satisfy."[42] But the Court then quoted from and endorsed Chancellor Strine's conclusion that he could not "understand how you would probe these decisions [about the structure and scope of the initial internal investigation] through any other means," given the participation of counsel in the decisions about structuring the investigation.[43] The Supreme Court also found that the record supported the application of the other *Garner* factors, including that the privileged communications were not about advice concerning the litigation itself[44] and that the plaintiff was not "blindly fishing" as it had asked for specific documents. Lastly, the Court noted that the allegations at issue concern potentially criminal conduct under the FCPA, which also supported production.[45]

The Supreme Court noted that the *Garner* doctrine traditionally had not been applied to work product documents.[46] The Court said, however, that an "overlap" existed between the *Garner* factors and "the required showing under the [Chancery Court] Rule 26(b)(3) work product doctrine," because Rule 26 provides "upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means."[47] According to the Supreme Court's analysis, where *Garner* is invoked because the information being sought is unavailable to a stockholder by other means, the analysis may not differ significantly from the showing of "substantial need" and "undue hardship" that can overcome work product protection. But the Court also noted that the work product analysis is "separate," even where the two analyses may overlap.[48]

> "As a result, the Supreme Court expressly said that Garner 'applied in plenary stockholder/corporation proceedings' and was applicable in Section 220 actions so long as the 'necessary and essential inquiry . . . precede[d] any privilege inquiry.'"

CONTINUED ON PAGE 8

40. *Id. at* *10-11.
41. *Id. at* *11.
42. *Id. at* *11.
43. *Id. at* *12.
44. However, the Chancery Court limited the production of privileged material after January 1, 2011, perhaps because at that point, the privileged material may have been more closely related to legal advice concerning pending or anticipated litigation than the investigation itself.
45. *Wal-Mart,* 2014 WL 3638848 at *13.
46. *Id. at* *13-14 (citing *Saito v. McKesson HBOC, Inc.*, No. Civ. A. 18553, 2002 WL 31657622, at *11 (Del. Ch. Nov. 13, 2002)).
47. *Id. at* *14; Ct. Ch. R. 26(b)(3).
48. *Wal-Mart,* 2014 WL 3638848 at *13-14.

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 7

V. Implications of Wal-Mart

In many respects, the *Wal-Mart* ruling presents as an unremarkable application of established legal requirements under the "proper purpose" and "necessary and essential" standards for a Section 220 demand. Even the adoption of the *Garner* standard by the Delaware Supreme Court, though a first because the Court had never explicitly endorsed *Garner*, is arguably a straightforward application of a well-established standard that has long held sway in the Chancery Court. What sets the *Wal-Mart* ruling apart, however, is that it provides stockholders and their counsel with a potential road-map for seeking and possibly obtaining an extensive set of documents about corporate internal investigations, especially in the FCPA context. Stockholders are sure to seize upon the ruling as a potential basis for far-reaching inquiries into the conduct of internal investigations. The key to any such effort will be the Supreme Court's apparent reliance on a part of the Chancery Court's ruling allowing such a production where "there is a colorable basis that part of the wrongdoing was in the way the investigation itself was conducted."[49] That portion of the Chancery Court ruling appeared to provide a foundation for the "proper purpose" determination and the conclusion that "good cause" existed for the production of privileged and work product documents.[50]

> "What sets the *Wal-Mart* ruling apart, however, is that it provides stockholders and their counsel with a potential road-map for seeking and possibly obtaining an extensive set of documents about corporate internal investigations, especially in the FCPA context."

The facts undergirding the *Wal-Mart* case are unusual to say the least. Rarely is an investigation of potential wrongdoing subjected to the level of intense scrutiny that has been given to the initial WalMex investigation. And the kinds of allegations contained in *The New York Times* article are almost unprecedented in their scope and detail. Stockholders in future cases are sure to attempt to portray other investigations as being similar to the facts of the *Wal-Mart* case – meaning that future investigations are likely to be subjected to extraordinary scrutiny to see whether they can be portrayed in terms similar to those in *Wal-Mart*. And counsel for stockholders can be expected to deploy investigators and other resources looking for current or former employees or other knowledgeable witnesses who may disagree with the way in which an inquiry was conducted. In cases where stockholders and their counsel believe they have colorable arguments supporting an inquiry into the conduct of an investigation, corporations responding to Section 220 demands are likely to face significantly greater challenges and the prospect of expedited trials in the Chancery Court.

Ultimately, it will be for the Chancery Court to determine whether the *Wal-Mart* ruling set a broad precedent or was nothing more than a narrow ruling on a unique set of facts. But until those rulings come, addressing Section 220 demands may be much more complicated than in the past – especially in FCPA cases where internal reviews already have been conducted.

Companies undertaking internal reviews of new FCPA issues (or other issues warranting an internal review) can and should anticipate these potential challenges by stockholders and structure their investigations from the outset in a way that is most likely to insulate the investigation from a successful Section 220 demand. That means taking appropriate steps to assure that no "colorable basis" exists for finding wrongdoing in the way the internal investigation was conducted. That does not mean that outside counsel will need to be retained in every case, or that the Audit Committee needs to be burdened with conducting every review, or that the scope of every inquiry needs to encompass broad

CONTINUED ON PAGE 9

49. *Id. at* *12.

50. *Id. at* *12-13.

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 8

segments of the company. But it does mean that extra care should be taken at the outset of an inquiry, when decisions about structure, supervision and scope are being made, to think about how those decisions could be perceived in the future, and to document the basis for the determinations about how the review was conducted.

To that end, counsel or compliance personnel considering how to structure and conduct future investigations may want to consider the following key decision points and document the rationale for the decisions that actually are made:

- **Who should conduct the review?** In some cases, a review by internal resources, including resources in a local business unit, may be perfectly appropriate. But where allegations or emerging evidence suggests the possible participation of local management, consideration should be given to having the review conducted by more independent and distant resources, such as internal audit or compliance personnel from the home office. Where there is any suggestion that members of senior management may have been implicated, including senior officials in a local business unit, careful consideration should be given to having outside counsel conduct the review – again using counsel who may be more independent of the local management who may be under scrutiny.
- **Who should supervise the review?** Supervision of any review is a critical component of the early decision-making process. Again, where local management could be implicated in any way in the wrongdoing, careful consideration should be given to having the review supervised by personnel at another location and who are senior to those being scrutinized. Where more senior management may be implicated, consideration should be given to having independent members of the Board oversee the review.

> "Extra care should be taken at the outset of an inquiry, when decisions about structure, supervision and scope are being made, to think about how those decisions could be perceived in the future, and to document the basis for the determinations about how the review was conducted."

- **What should be the scope of the review?** Any internal investigation can be an enormous diversion and drain on corporate resources – especially if extensive collection and review of documents and lengthy interviews are required. Companies understandably want to right-size any review to fit the allegations and potential risks. The Chancery Court trial in the Wal-Mart case illustrates, however, that even seemingly minute details about the conduct of a review can be subjected to close scrutiny. As reflected in the Chancery Court's order following the trial, the names of specific document custodians were identified and the manner of conducting document collection (from server data, backup tapes, BlackBerry servers and hand-held devices) was extensively reviewed and became the subject of controversy and the Court's order.[51] Here again, companies and counsel should consider at the outset the depth of analysis and inquiry that is warranted by the allegations. In particular, it is important from the outset to not prejudge the outcome of a review by being unnecessarily dismissive of serious allegations simply because they come from a questionable source or because they raise concerns about a senior corporate official – even one with a sterling reputation. For example, allegations concerning actions by one individual in a mid-level management position may warrant a scope that is initially limited, but allegations of extensive misconduct by multiple employees including more senior officials almost always will warrant an investigation of a different scale.

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51. *Indiana Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.* Final Order and Judgment, No. 7779-CS, 2013 WL 5636296 (Del. Ch. Oct. 15, 2013).

Documents Now at Risk: The *Wal-Mart* Ruling ■ Continued from page 9

There is no "one-size-fits-all" solution to the question of how a review should be structured, supervised, and conducted. Each situation is unique and each situation needs its own analysis of the potential risks presented by the underlying allegations and the potential costs of getting to the bottom of what may have gone wrong. In light of *Wal-Mart*, this is more true than ever. As companies consider how to structure internal investigations, they should do so bearing in mind the real possibility that their early decisions will be subjected to close and critical scrutiny. Where those decisions are internally controversial, consider how that controversy will be viewed in the future if the problem turns out to be bigger than initially expected. As investigations mature, if evidence accumulates that adds credence to the allegations, as appeared to happen in the initial Wal-Mart inquiry, consideration should be given to promptly expanding the scope of inquiry and potentially reconsidering who should conduct and supervise the review. Companies should make their early decisions in any investigation by thinking about how they may be required to explain those decisions to stockholders making Section 220 demands and potentially to a Delaware Chancellor to convince both that there is no "colorable basis" for deciding that there was any wrongdoing in the conduct of the investigation itself.

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The SEC *Noble* Prosecution: Takeaways from the *O'Rourke*, *Jackson* and *Ruehlen* Settlements

I. Introduction

In the realm of FCPA enforcement, where the vast majority of cases are settled before the filing and litigation of formal charges, it is often hard to compare the outcomes of early and eve-of-trial or post-trial settlements in any meaningful way. The Noble case, however, provides a rare opportunity to engage in such a comparison, not only because it was litigated by the SEC farther than almost any other FCPA case has been, but also because it involved both pre-and post-litigation settlements for individual defendants based on charges arising out of the same series of events.

In February 2012, the U.S. Securities and Exchange Commission ("SEC") charged three executives of Noble Corporation with violating various provisions of the FCPA and related laws in the course of their interactions with public officials in Nigeria's energy sector.[1] One of these defendants, Thomas O'Rourke, promptly settled with the SEC, accepting permanent injunctions against future violations as to every count on which he was charged, and agreeing to pay a $35,000 civil penalty.[2]

The remaining individual defendants, Mark Jackson and James Ruehlen, decided to litigate.[3] On July 2, 2014 – less than a week before trial was to start and after more than two years of litigation – the SEC settled with these two defendants.[4] Although Jackson and Ruehlen agreed to be enjoined from future violations of the books and records provision of the FCPA, the settlements in their matters were notable in that the vast majority of the charges in the initial complaint, including the bribery charges, were conspicuously absent from the settlements, and no monetary penalties were imposed.[5]

Although the Noble case offers just one data point, the outcomes for the three defendants raise important questions about both the difficulties of litigating these types of cases for the SEC and the potential advantages of declining pre-trial settlement for would-be defendants. In addition, the SEC's litigation strategy in these cases highlights some possible problems with the expansive interpretation of the FCPA that the SEC and the Department of Justice ("DOJ") have advanced in recent FCPA cases. These problems, highlighted in the District Court's refusal to accept the SEC's interpretation on certain key issues, such as the scope of the facilitation payments exception, as well as the concrete impact of the U.S. Supreme Court's *Gabelli* decision (133 S. Ct. 1216 (2013)) in gutting large portions of the SEC's claims for penalty relief, will doubtless affect future litigation, as well as the "market" for SEC (and in certain respects, DOJ) settlements for years to come. But at the same time, the SEC's losses on these key issues, which drove the favorable settlements with Jackson and Ruehlen, could well incentivize the SEC to dig deeper, and earlier, for the evidence needed to sustain its burdens in FCPA matters.

II. Background of the Noble Case

In the Noble case, Noble Drilling (Nigeria) Ltd. ("Noble-Nigeria")[6] was accused of bribing Nigerian customs officials in exchange for the grant of what the SEC alleged were illegitimate Temporary Import Permits ("TIPs") for Noble's drilling rigs.

According to the SEC's original complaint, Noble-Nigeria made illegal payments both to obtain false paperwork for new TIPs and to extend its existing TIPs – which normally are obtained through an

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1. *S.E.C. v. Thomas O'Rourke,* No. 4:12-cv-00564, Complaint (S.D. Tex. Feb. 24, 2012); *S.E.C. v. Jackson,* No. 4:12-cv-00563, Complaint (S.D. Tex. Feb. 24, 2012).
2. *S.E.C. v. Thomas O'Rourke*, No. 4:12-cv-00564, Final Judgment (S.D. Tex. March 28, 2014); *see* SEC Press Rel. 2012-32, SEC Charges Three Oil Services Executives with Bribing Customs Officials in Nigeria (Feb. 24, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171487432.
3. *See S.E.C. v. Jackson*, No. 4:12-cv-00563 (S.D. Tex. 2012).
4. *See* SEC Litig. Rel. 23038, SEC Settles Pending Civil Action Against Noble Executives Mark A. Jackson and James J. Ruehlen (July 17, 2014), http://www.sec.gov/litigation/litreleases/2014/lr23038.htm.
5. *S.E.C. v. Jackson*, No. 4:12-cv-00563, Final Judgment (S.D. Tex. July 3, 2014).
6. Noble-Nigeria was a wholly owned subsidiary of Noble Corporation, an international provider of offshore drilling services and equipment.

The SEC Noble Prosecution ■ Continued from page 11

application process and permit temporary use of Nigerian resources for one year, with three discretionary six-month extensions – more than three times without moving the rigs out of, and then back into, Nigerian waters, as otherwise would be required.[7] These allegedly unlawful TIPs permitted Noble-Nigeria to operate its offshore drilling rigs without paying duties associated with permanent import status being applied to its drilling equipment and without having to shut down its operations and exit Nigerian waters while applying for a new TIP.[8]

In addition to the charges brought by the SEC (and also the DOJ) against Noble-Nigeria's parent, Noble Corporation, the SEC also brought charges against three executives: Mark Jackson, who held various positions at the Noble Corporation, including that of Chief Executive Officer, Chief Operations Officer, Chief Financial Officer, and President; James Ruehlen, director and division manager of Noble-Nigeria; and Thomas O'Rourke, at different times director of internal audit and controller.[9]

The SEC alleged that Ruehlen requested from Jackson the authority to promise the bribe payments or make the payments themselves and that the two then knowingly recorded the illegal payments as legitimate business expenses.[10] The SEC complaint also cited past violations by Noble-Nigeria either facilitated or ignored by Ruehlen and Jackson.[11] With regard to O'Rourke, the SEC focused on the discharge of his oversight responsibilities, alleging that he helped approve the illegal payments and allowed the bribes to be booked improperly as legitimate expenses.[12]

> "The way in which the SEC litigated against, and then settled with, Jackson and Ruehlen is notable both for the disparate outcome compared to the O'Rourke settlement and the challenges that the agency faced – both legally and factually – throughout."

Of the four defendants charged, two – Noble Corporation and O'Rourke – settled the claims against them. Noble Corporation settled with both the SEC and the DOJ in 2010, paying disgorgement of $5.57 million to the former[13] and signing a non-prosecution agreement that included a $2.59 million criminal penalty with the latter.[14] O'Rourke, charged separately only by the SEC, settled as well, paying a $35,000 penalty in 2012 and consenting to injunctions preventing future violations of each of the statutes under which he was charged, which included prohibitions on aiding and abetting bribery and books and records violations, and violating the FCPA's internal controls requirements.[15] The remaining two defendants, Jackson and Ruehlen, against whom the DOJ had also not brought charges, chose to litigate the SEC's civil charges that were filed against them.

III. Litigation of the Noble Case by the SEC

The way in which the SEC litigated against, and then settled with, Jackson and Ruehlen is notable both for the disparate outcome compared to the O'Rourke settlement and the challenges that the agency faced – both legally and factually – throughout. At the outset of this litigation, the SEC was likely confident that it could successfully bring charges against both remaining individual defendants, particularly in light of the

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7. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Complaint (S.D. Tex. Feb. 24, 2012), ¶¶ 18-32.
8. *See id.*
9. The DOJ also brought charges against Noble Corporation, but chose not to charge the individuals.
10. *See id.* at ¶ 38.
11. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Complaint (S.D. Tex. Feb. 24, 2012), ¶¶ 52-53.
12. *See S.E.C. v. Thomas O'Rourke*, No. 4:12-cv-00564, Complaint (S.D. Tex. Feb. 24, 2012).
13. *See* SEC Litig. Rel. 21728, *SEC Charges Noble with FCPA Violations* (Nov. 4, 2010), http://www.sec.gov/litigation/litreleases/2010/lr21728.htm.
14. *See* DOJ Press Rel. 10-1251, Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More Than $156 Million in Criminal Penalties (Nov. 4, 2010), http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html.
15. *See* SEC Press Rel. 2012-32, SEC Charges Three Oil Services Executives with Bribing Customs Officials in Nigeria (Feb. 24, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171487432.

The SEC Noble Prosecution ■ Continued from page 12

terms of the settlement that it had reached with O'Rourke. In its 46-page initial complaint, the SEC laid out, in detail, specific affirmative acts allegedly committed by each of the defendants over a period of roughly four years, from 2002 to 2007,[16] as well as a multitude of red flags that were allegedly ignored or covered up.[17] The charges included bribery, books and records violations, circumvention of internal controls, and making false and misleading statements, and included, in the case of Jackson, control person liability.

On May 8, 2012, Jackson and Ruehlen each filed a motion to dismiss, challenging both the manner in which the SEC had pled its complaint and the SEC's interpretation of certain elements of the FCPA as unconstitutionally vague.[18] Specifically, with respect to the pleadings, Jackson and Ruehlen alleged that the there was no distinction between permissible facilitation payments and bribes; that there was inadequate identification of the officials involved; that there were insufficient allegations relating to motive and intent; and that no particular books, records, or internal controls had been identified as violated.[19] Both Jackson and Ruehlen also argued that the alleged misconduct occurred outside of the five-year statute of limitations period, and thus was not timely charged. The SEC opposed this motion, challenging the pleading requirements that defendants argued had not been met.[20] With regard to the statute of limitations, the SEC argued that the complaint was timely, but that, in any event, the statute of limitations had been tolled both under the continuing violations doctrine and under the fraudulent concealment doctrine, extending the limitations period.[21]

A. Statute of Limitations and Gabelli

In litigating this motion to dismiss, one of the biggest challenges for the SEC was the statute of limitations issue. This issue was clouded by the concurrent litigation of *S.E.C. v. Gabelli*, which stood to determine the applicability of the discovery rule – allowing a cause of action to accrue upon discovery of the violation rather than when the violation actually took place[22] – to penalty claims brought by the SEC, which are governed by 28 U.S.C. § 2462. Specifically, in August 2011, the Second Circuit handed down an opinion reversing a District Court order that had earlier held that the discovery rule did not apply to the SEC,[23] creating a circuit split[24] and prompting a petition for *certiorari* on the issue to be filed in, and then, while motion practice was ongoing, an order

"Th[e statute of limitations] issue was clouded by the concurrent litigation of *S.E.C. v. Gabelli,* which stood to determine the applicability of the discovery rule – allowing a cause of action to accrue upon discovery of the violation rather than when the violation actually took place – to penalty claims brought by the SEC, which are governed by 28 U.S.C. § 2462."

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16. *S.E.C. v. Jackson*, No. 4:12-cv-00563, Complaint (S.D. Tex. Feb. 24, 2012) at ¶¶18-149.
17. *See generally id.*
18. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant James J. Ruehlen's Motion to Dismiss Plaintiff's Complaint for Failure to State a Claim and Memorandum in Support Thereof (S.D. Tex. May 8, 2012), 23-34 ("Ruehlen Motion to Dismiss"); *S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant Mark A. Jackson's Motion to Dismiss the Complaint under Rule 12(b)(6) for Failure to State a Claim Upon Which Relief Can Be Granted (S.D. Tex. May 8, 2012), 19-20 ("Jackson Motion to Dismiss").
19. See sources cited at n. 18.
20. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Plaintiff's Consolidated Response in Opposition to Defendants Jackson's and Ruehlen's Motions to Dismiss (S.D. Tex. June 22, 2012).
21. *See id.* Argument Section E.
22. *See id.*
23. *See S.E.C. v. Gabelli*, 653 F.3d 49, 60-61 (2d Cir. 2011), *rev'd*, 133 S. Ct. 1216 (2013).
24. *See 3M Co. v. Browner*, 17 F.3d 1453, 1462-63 (D.C. Cir. 1994); *FEC v. Williams*, 104 F.3d 237, 240 (9th Cir. 1996); *United States v. Core Labs., Inc.*, 759 F.2d 480, 481-83 (5th Cir. 1985); *United States v. Witherspoon*, 211 F.2d 858, 861 (6th Cir. 1954).
25. *See Gabelli v. SEC*, 2012 WL 1419938, Pet. for Writ of Cert. (Apr. 20, 2012). The Petition for Certiorari was granted on September 25, 2012. (Docket Case No. 11-274).

The SEC Noble Prosecution ■ Continued from page 13

granting review by, the United States Supreme Court.[25]

Jackson and Ruehlen's motion papers pointed to cases in the other circuits – including an arguably precedential Fifth Circuit case[26] – in which the courts had held that claims under Section 2462 accrue at the time of violation.[27] In the case of Jackson and Ruehlen, they argued, under this regime claims concerning any conduct that occurred before February 24, 2007 – *i.e.*, most of the allegedly unlawful conduct at issue – would be time barred.[28] The defendants also noted that the SEC failed to plead any other grounds for tolling the statute of limitations, arguing that there was no fraudulent concealment and that there was no mention of tolling agreements in the complaint.[29]

In its response filed on June 22, 2012, the SEC first invoked the tolling agreements it had entered into with Jackson and Ruehlen, and then offered a number of other arguments as to why the acts prior to five years before the SEC filed suit would still be timely.[30] As a threshold matter, the agency noted that the statute of limitations would not apply to equitable remedies.[31] With regard to monetary penalties, the SEC did not argue in detail that the discovery rule was a valid basis for its claims, but instead focused on two alternative theories for tolling the statute of limitations, after giving a brief nod to the *Gabelli* litigation.[32] *First*, the SEC argued that the failure to keep accurate books and records is "inherently continuing in nature" and continued into May 2007, which made the claims of violations of the FCPA's books and records provisions timely even if the violations began outside of the limitations period.[33] *Second*, the SEC argued that both the falsification of the company's books and records and the delayed notification of misconduct fulfilled the requirements of fraudulent concealment, which would also be a ground for tolling the limitations period.[34]

In deciding this motion to dismiss, Judge Ellison agreed that the claims accruing before February of 2007 should be time-barred, unless the SEC amended its complaint to plead expressly the continuing violations exception.[35] Further, the District Court held that, although the continuing violations doctrine could be applied to the books and records or the internal control violations alleged, it could not be applied to any charges as to which at least one violation referenced therein had not occurred within the statute of limitations period.[36]

"[T]he District Court held that, although the continuing violations doctrine could be applied to the books and records or the internal control violations alleged, it could not be applied to any charges as to which at least one violation referenced therein had not occurred within the statute of limitations period."

As for the SEC's contentions about fraudulent concealment, the District Court noted the requirement that the SEC must exercise reasonable diligence in discovering the fraud despite allegedly wrongful concealment by the defendants, and gave the SEC leave to amend its complaint in

CONTINUED ON PAGE 15

26. *United States v. Core Labs., Inc.*, 759 F.2d 480, 481-83 (5th Cir. 1985).
27. *See, e.g.*, *SEC v. Microtune, Inc.* 783 F. Supp. 2d 867, 873 (N.D. Tex. 2011); *United States v. Core Labs, Inc.*, 759 F.2d 480, 482 (5th Cir. 1985); *Trawinski v. United Techs.*, 313 F.3d 1295, 1298 (11th Cir. 2002).
28. *See* Ruehlen Motion to Dismiss at 23-24; Jackson Motion to Dismiss at 19-20.
29. *See* Ruehlen Motion to Dismiss at n.17; Jackson Motion to Dismiss at 20-22, n.22. Both defendants acknowledge that they did sign tolling agreements with the SEC that pushed the actionable date back to May 10, 2006, but point out that "because the SEC failed to plead the existence of those agreements in its Complaint . . . their existence ought not be considered for the purposes of this Motion to Dismiss." Ruehlen Motion to Dismiss at n.17.
30. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Plaintiff's Consolidated Response in Opposition to Defendants Jackson's and Ruehlen's Motions to Dismiss (S.D. Tex. 2012), 43-48.
31. *See id.* at 48.
32. *See id.* at 45-47.
33. *Id.* at 45; *see id.* at 45-46.
34. *See id.* at 46-47.
35. *See SEC v. Jackson*, 908 F. Supp. 2d 834, 873 (S.D. Tex. 2012).
36. *See id.* at 872.
37. *See id.* at 871.

The SEC Noble Prosecution ■ Continued from page 14

order to plead properly such diligence.[37] In his opinion, Judge Ellison noted that "the statute is not automatically tolled until such a time that plaintiff actually had all of the knowledge necessary to state a claim; rather, a plaintiff must show that he acted diligently upon learning any facts that should have 'excite[d] inquiry'"[38] and cited to the Second Circuit's decision in *Gabelli* "noting that, in the context of the discovery rule, defendants bear the burden of proving that a 'reasonably diligent plaintiff would have discovered this fraud' earlier."[39] He went on to acknowledge that "the Fifth Circuit has unambiguously held that plaintiffs would 'ultimately bear the burden of persuasion on the question of diligence' [and] [t]his Court is bound by that precedent."[40]

"In his December 11, 2012 memorandum and order dealing with the motions to dismiss, Judge Ellison held that it was the SEC's burden both to negate the applicability of the facilitating payments exception and to show the defendants' intent wrongfully to influence foreign officials."

In light of this ruling, the SEC filed an amended complaint on January 25, 2013 – less than three weeks after oral argument in the Supreme Court in *Gabelli* – and in this pleading alleged in greater detail its diligence in discovering the fraud and explicitly mentioned the tolling agreements signed by the defendants.[41] Again, the SEC did not rely on the discovery rule.

On February 27, 2013, the Supreme Court handed down its decision in *Gabelli*, holding that the SEC was not entitled to the benefit of the discovery rule in seeking monetary penalties.[42] A month later, on March 25, 2013, the SEC filed a second amended complaint against Jackson and Ruehlen, limiting the civil penalties sought to alleged wrongdoing that took place after May 2006, per the tolling agreements entered into with those defendants. The equitable remedies sought, however, still covered the entire period of alleged misconduct, presumably relying on the concept that both the doctrine of laches and the doctrines underlying the grant of equitable remedies against law violators were more flexible than the *Gabelli* rule.[43]

B. Facilitating Payments and Reliance on Counsel

In addition to the statute of limitations issue, Jackson and Ruehlen raised a second argument in their motion to dismiss that arguably presented an even greater threat to the SEC, and likely weighed heavily in the agency's ultimate decision to settle. As mentioned above, Jackson and Ruehlen asserted that, to the best of their knowledge at the time of the alleged misconduct, the payments at issue were permissible facilitation payments and not illegal bribes. In addition and relatedly, Jackson and Ruehlen argued that they lacked the requisite *mens rea* for the "corrupt intent" element of an FCPA bribery charge, and thus were not civilly liable with respect to any such offense related to the allegedly impermissible payments.[44]

In his December 11, 2012 memorandum and order dealing with the motions to dismiss, Judge Ellison held that it was the SEC's burden both to negate the applicability of the facilitating payments exception and to show the defendants' intent wrongfully to influence foreign officials.[45] The complaint did, according to Judge Ellison, allege the statutory elements with regard to the falsified TIPs, but

CONTINUED ON PAGE 16

38. *Id.* at 868-69 (alteration in original) (quoting *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1171 (5th Cir. 1979)).
39. *Id.* at 869 (quoting *Gabelli*, 653 F.3d at 60-61).
40. *Id.* (quoting *Texas v. Allan Constr. Co.*, 851 F.2d 1526, 1533 (5th Cir. 1988)).
41. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Amended Complaint (S.D. Tex. Jan. 25, 2013), 50-51.
42. *Gabelli v. S.E.C.*, 133 S. Ct. 1216, 1224 (2013). The Court stated that the purpose of the discovery rule was to preserve the claims of injured parties who were unable to obtain compensation for those injuries due to the difficulty of discovering their injury and held that because the sole function of the SEC is to investigate potential instances of non-compliance the purposes of the discovery rule are inapplicable in an SEC enforcement context. *See id.* at 1222.
43. *See S.E.C. v. Jackson,* No. 4:12-cv-00563, Second Amended Complaint (Mar. 25, 2013).
44. *See* Ruehlen Motion to Dismiss 13-17; Jackson Motion to Dismiss 13-19.
45. *See SEC v. Jackson,* 908 F. Supp. 2d at 857, 860.

The SEC Noble Prosecution ■ Continued from page 15

failed to do so with regard to discretionary extensions of existing TIPs.[46] Accordingly, the Judge gave the SEC leave to amend its complaint to more comprehensively plead the alleged wrongdoing within the framework of the District Court's ruling. The SEC subsequently filed two amended complaints attempting to remedy the weaknesses in its pleadings that the Court's ruling had identified.

A number of months after filing its second amended complaint, the SEC again took on the facilitating payments issue and moved for summary judgment on certain points, claiming that, as a matter of law, the facilitation payments exception was inapt.[47] The SEC insisted that the numerous consecutive extensions to the TIPs were contrary to Nigerian law, which limited the number of permissible extensions to an existing TIP.[48] This, according to the SEC, disposed of the facilitation payments issue; if the acts were illegal, there would be no "routine" act to facilitate.[49] The SEC further argued that, even if defendants thought the extensions were permissible under Nigerian law, the decision to grant extensions was discretionary, and thus the facilitating payments exception likewise should not apply.[50]

> "[T]he defendants went further to focus the court on the evidence indicating that the entirety of the conduct at issue had been transparently disclosed within the context of a compliance program that had been developed with the assistance of outside counsel."

The defendants responded that this did not solve the *scienter* issue and asserted they were not aware that the requested extensions were impermissible or discretionary.[51] They reasserted the absence of any evidence of "corrupt intent" behind their actions, and continued to emphasize that the proper inquiry regarding the exception is the purpose of the payments and not their effect.[52] In fact, the defendants went further to focus the court on the evidence indicating that the entirety of the conduct at issue had been transparently disclosed within the context of a compliance program that had been developed with the assistance of outside counsel.[53] In their respective roles as officers, they argued, they were entitled to rely, and did in fact rely, on the professional opinions of these advisors.[54]

On May 29, 2014, Judge Ellison heard argument on the parties' motions for summary judgment, which had focused on the interpretation of the facilitation payments exception and the meaning of the FCPA's "intent" requirement. Jackson's lawyer argued first, leading the District Court through each of the payments made and focusing on the advice upon which the defendants relied in deeming the payments to be lawful under the FCPA. This advice was extensive – including a review of Noble's compliance program by outside counsel, an audit by PricewaterhouseCoopers, legal advice from the company's general counsel, and an opinion from Nigerian counsel (later hotly disputed by the SEC) – and none indicated

CONTINUED ON PAGE 17

46. *See id.* at 862.
47. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, SEC's Motion for Partial Summary Judgment on Inapplicability of Facilitating Payment Exception and Memorandum of Law in Support (S.D. Tex. Mar. 28, 2014).
48. *See id.* at 31-33.
49. *See id.* at 29-30.
50. *See id.* at 33-35.
51. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant James J. Ruehlen's Motion for Summary Judgment and Memorandum of Law in Support (S.D. Tex. Mar. 28, 2014), 19-26; *S.E.C. v. Jackson*, No. 4:12-cv-00563 , Defendant Mark A. Jackson's Motion for Summary Judgment (S.D. Tex. Mar. 28, 2014), 19-31.
52. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant James J. Ruehlen MSJ and Memorandum of Law in Support 19-26; *S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant Mark A. Jackson MSJ 19-31.
53. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant James J. Ruehlen MSJ and Memorandum of Law in Support 10-15; *S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant Mark A. Jackson MSJ 20-24.
54. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant James J. Ruehlen MSJ and Memorandum of Law in Support 23-26; *S.E.C. v. Jackson*, No. 4:12-cv-00563, Defendant Mark A. Jackson MSJ 22-24.

The SEC Noble Prosecution ■ Continued from page 16

any concern about the recorded facilitation payments.[55] Ruehlen's counsel echoed these arguments, also advancing an "actual knowledge" standard for allegedly improper payments and arguing that the advice received strongly indicated that neither Jackson nor Ruehlen possessed the requisite mental state for civil FCPA liability.[56]

> "[T]hat neither the defense nor the prosecution had obtained the testimony of the Nigerian legal expert whose advice was at issue raised the thorny problem of who carried the burden to produce the witness after defendants testified to their reliance on her advice."

The SEC first responded by challenging the actual knowledge standard, arguing that deliberate ignorance is not an excuse under the FCPA.[57] Still, recognizing that the crux of the case related to knowledge of wrongdoing, the government turned its focus to the meaning of the phrase "corrupt intent."[58] Noting that the exception requires "purpose to expedite . . . a routine government action,"[59] the government dedicated the majority of its argument to the state of Nigerian law, advocating for "an objective inquiry that relies on what the law in the country requires."[60] In the SEC's view, the key issue was the discretion implicated in TIP issuance decisions, which removed them from the realm of permissible facilitation payments.[61] The SEC also argued that the books and records provisions of the statute did not require the same intent as the bribery provisions.[62]

Judge Ellison's questions during oral argument indicated a concern that, although the defense's case turned on the receipt of legal advice that indicated no wrongdoing, the record on that issue was less than ideal.[63] In particular, that neither the defense nor the prosecution had obtained the testimony of the Nigerian legal expert whose advice was at issue raised the thorny problem of who carried the burden to produce the witness after defendants testified to their reliance on her advice.[64] In addition, the judge appeared uncomfortable with being given the task of interpreting Nigerian law, particularly at the summary judgment stage. In fact, at various points throughout the hearing, Judge Ellison queried whether, as a legal matter, the clear factual disputes being argued, including issues of intent, flatly barred granting any party summary judgment.[65]

After two days of argument on these and other matters, Judge Ellison issued an oral decision from the bench denying all of the parties' motions for summary judgment. Though he did not elaborate upon the basis for this ruling, the transcript suggests the District Court appeared to believe that there were a number of genuine disputes of material fact that needed to go to the jury, as was "clear from [the Court's] questions" throughout the proceedings.[66] Nevertheless,

CONTINUED ON PAGE 18

55. During oral argument, defendants described the elements of an extensive compliance program which, on their evidence, had been implemented and was working, and reliance on advice of (i) experienced executives who stated that the payments were required and permissible under Nigerian Law, (ii) an outside law firm specializing in FCPA issues that evaluated Noble's compliance program and found it to be "excellent," (iii) Noble's General Counsel, (iv) an outside audit firm that stated that the additional TIP extensions were permissible and flagged no issues with the payments that were booked as facilitation payments, and (v) the company lawyer from Nigeria who stated that the payments were legal under Nigerian Law. The SEC disputed this evidence, and maintained that there was almost no evidence beyond the word of the interested parties that such advice had ever been received. In particular, there was significant dispute over the alleged advice of Nigerian counsel Jo Onodugo, whose direct testimony had not been obtained by the other side. *See, e.g., S.E.C. v. Jackson*, No. 4:12-cv-00563, Transcript of Proceedings – Motion Hearing for Summary Judgment (S.D. Tex. May 29, 2014) 13-33, 53-54, 57-64, 77-80, 104-09, 118-21, 126-32, 138-48, 154-59, 160-62.

56. *See id.* at 61-63.

57. *See id.* at 36-37.

58. *Id.* at 38.

59. *Id.* at 43.

60. *Id.* at 44.

61. *See id.* at 54.

62. *See id.* at 51-52.

63. *Id.* at 62.

64. *See id.* at 166-172.

65. *See, e.g., id.* at 151, 186.

66. *S.E.C. v. Jackson*, No. 4:12-cv-00563, Transcript of Proceedings – Motion Hearing for Summary Judgment (S.D. Tex. May 30, 2014), 138-39; *see, e.g., id.* at 6, 17, 20-21, 38, 50, 81, 132, 134; *see also, e.g., S.E.C. v. Jackson*, No. 4:12-cv-00563 Transcript of Proceedings – Motion Hearing for Summary Judgment (S.D. Tex. May 29, 2014) 63, 100-111, 149, 155-56.

The SEC Noble Prosecution ■ Continued from page 17

the transcript does give some indication of the Court's receptiveness to the parties' arguments, indicating areas of potential risk for the SEC. For example, Judge Ellison appeared to be somewhat persuaded by the defendants' argument that receiving legal advice as to the payments could exculpate defendants, at least from the primary FCPA anti-bribery charges against them, if they acted in reliance of such advice. The Court did not, moreover, appear to be entirely persuaded by the SEC's argument that the presence of administrative discretion to grant a requested benefit automatically meant that the statutory facilitating payments exception, which makes no mention of government discretion, could not apply.

V. The Jackson and Ruehlen Settlements and Their Implications

On July 2, 2014, just days before trial, Jackson and Ruehlen settled with the SEC without agreeing to pay any monetary penalties or to disgorge any money allegedly received by reason of their alleged misconduct or to make any admissions of guilt.[67] Of the ten remaining charges against Jackson and the six charges against Ruehlen, the settlements in each case mentioned only one books and records charge; Jackson agreed to a permanent injunction against violating the books and records provisions set forth in Section 13(b)(2)(A) of Title 15 as a "control person,"[68] and Ruehlen agreed to a permanent injunction against aiding and abetting a violation of the same, in his individual capacity.[69] Neither Jackson and Ruehlen admitted or denied the allegations in the SEC's complaints. By way of contrast, O'Rourke's pre-litigation settlement included injunctions with respect to all five of the charges against him, as well as a civil penalty of $35,000, notwithstanding that the facts pleaded by the SEC were subject to the same statute of limitations bar that was ultimately decided in Jackson's and Ruehlen's favor.

Though the SEC's decision to settle with Jackson and Ruehlen – the more senior of the executives charged in the Noble matter – was undoubtedly the product of an assessment of many factors, it is likely that the denial of the agency's motion for summary judgment and the potential for adverse rulings on the issue of facilitation payments and reliance on advice of counsel played a large role. The agency also faced an uphill battle relating to the statute of limitations. Given the leverage of the defendants at that juncture, they were able to obtain what was, objectively, a more favorable settlement than O'Rourke's.

The Noble case raises important questions about the SEC's expansive interpretation of the FCPA and the practical challenges that government attorneys face in court. Doubtless the SEC took into account the risk that a broad interpretation of the facilitating payments exception could have blown a significant hole in the agency's enforcement agenda. Additionally, particularly following discovery, oral argument, and questions by the judge that brought to the fore many specific facts about Noble's compliance program, the agency doubtless assessed the

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CONTINUED ON PAGE 19

67. *See S.E.C. v. Jackson*, No. 4:12-cv-00563, Joint Stipulation and Motion for Entry of Final Judgments (July 2, 2014).

68. *See id.* Ex. A at 1-2.

69. *See id.* Ex. C at 1-2.

The SEC Noble Prosecution ■ Continued from page 18

equity of proceeding to trial in a case in which a company had at least attempted to do exactly what U.S. enforcement officials had been advocating for years – establish compliance programs with the assistance of outside advisors and counsel, escalate issues within the organization, and, when necessary, seek the guidance of local counsel in the relevant jurisdiction. The particulars of the Noble compliance program and the specific conduct at issue could well be debated for years, and in-house counsel and compliance professionals may wish to consult these particulars to determine how to improve their programs and program execution to reduce even further the risk of government scrutiny. Nevertheless, one critical conclusion is that, depending on the facts, it very well may make sense not to settle early, but to force the government to its proof and to seek judicial rulings on important unresolved questions of law, of which there remain many under the FCPA.

Beyond these lessons, those subject to the FCPA cannot take too much solace from the outcome in the Jackson and Ruehlen cases. In contrast to O'Rourke, who was at least able to put the matter behind him at a relatively early date, Jackson and Ruehlen each litigated for years before settling, with all the attendant risks of doing so. Both Jackson and Ruehlen will remain subject to injunctions under the FCPA's accounting provisions. Moreover, the SEC will no doubt assess what can be done to strengthen its hand in future cases – perhaps acting more quickly to initiate investigations (and obtain tolling agreements) and also acting more pro-actively to secure the live testimony of witnesses abroad. The SEC also may determine, in other cases, notwithstanding the outcomes here, to press its broad view of the FCPA (and a narrow view of the facilitating payments exception) as the applicable law in FCPA matters.

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