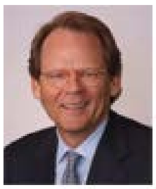
KING & SPALDING

Business Lit Ledger



In this Fall 2014 issue of our quarterly newsletter we have several substantive articles on issues that many of our clients are facing. For example our appellate team has an article addressing False Claims Act cases and dismissal of qui tam actions. Our clients face more and more of these suits and we have used that experience to develop deep knowledge on strategies for dismissal that we hope will be of interest. Our securities litigators have a commentary in this newsletter on the Delaware Supreme Court extending shareholder books and records inspection rights to privileged internal investigation documents. The antitrust team has authored a piece entitled "Stopping the DOJ at the Border? A New Defense to Reach of Federal Extraterritorial Criminal Prosecution." You will also find articles in this issue from our class action team discussing California's Automatic Renewal Statute and a discussion on the recent new Jersey Supreme Court case regarding common interest privilege. Our national business litigation team handles every variety of commercial dispute in cases around the county. We hope this newsletter is informative and helpful to you and we welcome your feedback. We are committed to being the most trusted, value added, and service driven choice of counsel for our clients.

Robert Meadows
King & Spalding National Business Litigation Team Leader

Important Legal Developments

Promoting the False Claims Act By Dismissing Meritless Qui Tam Actions

The False Claims Act's qui tam action is a distinctive and atypical form of litigation. Through the qui tam mechanism, Congress created a unique way for the United States to recover for false claims by empowering private persons—relators—to file suit "for the person and for the United States Government." 31 U.S.C. § 3730(b). While allowing private persons to file suit on behalf of the government, Congress ensured through a variety of means that the government would retain substantial control over cases brought in its name. In addition to the government's powers to intervene and take over the prosecution of a qui tam action, to settle such an action, and to limit or even halt discovery that would interfere with a government investigation, the government also has the power to unilaterally "dismiss [a qui tam] action notwithstanding the objections" of a relator. Id. § 3730(c)(2)(A). Yet the most striking thing about the government's dismissal power is how rarely the government exercises it—only a handful of times since the 1986 amendments to the False Claims Act created the modern qui tam action. More »

Fall 2014

Client Victories

King & Spalding Wins Dismissals for Omnicare in Separate FCA Cases in Georgia and New York, Recovering Partial Defense Costs
More »

KPMG's Motion for Summary Judgment Granted in Federal U.S. Virgin Islands Tax Shelter Malpractice Case
More »

Publications and Presentations

Insurance Coverage for Emerging Social Media Risks More »

DOJ Fines Berkshire Hathaway $896,000 for Failure to Comply with Premerger Notification Requirements More »

Access King & Spalding's other recent publications and presentations More »

Team News

King & Spalding Antitrust Cartel Practice Continues to Receive National Recognition
More »

Delaware Supreme Court Extends Shareholder Books and Records Inspection Rights to Privileged Internal Investigation Documents

A recent decision of the Delaware Supreme Court approved granting shareholders the right to inspect privileged and confidential internal investigation materials upon showing "good cause." Directors and general counsels should be aware of the Wal-Mart decision because it reflects continued heightened scrutiny of the board's role in compliance oversight and subjects sensitive internal investigation documents protected by "the oldest privilege recognized by Anglo-American jurisprudence" to inspection by shareholders seeking to substantiate claims that directors breached their fiduciary duties. The Wal-Mart decision could also trigger an increase in shareholder requests to inspect corporate books and records related to potential regulatory/legal violations. More »

Stopping the DOJ at the Border? A New Defense to the Reach of Federal Extraterritorial Criminal Action

In a one-day Department of Justice Antitrust Division takedown last September, nine international companies based outside the United States pled guilty to criminal antitrust violations and agreed to pay over $740 million in fines. In our increasingly globalized world, federal law enforcers have investigated and prosecuted numerous foreign corporations with limited presence in the United States for violations of U.S. criminal laws. Whether in cartel, corruption, or other international cases, foreign companies and their employees have chosen to submit to U.S. jurisdiction, sometimes facing hundreds of millions of dollars in fines and jail time.

With this background, it may come as a surprise to American corporations that their foreign counterparts—joint venture or business partners—may be able to successfully challenge U.S. criminal charges on a technical ground: failure to properly serve charges. The few foreign corporations to have attempted this argument have met with moderate success because the Federal Rules of Criminal Procedure do not address service of process overseas. Although the law on this topic is inconsistent, it is abundantly clear that American companies may stand alone in court if they are ever charged with criminal wrongdoing in conjunction with a foreign business relationship because their foreign partner may be beyond the reach of service of process by the United States. More »

California's Automatic Renewal Statute Creates Risk of Class Action Litigation

California's General Assembly enacted a statute in 2009 that purports to prevent California residents from unknowingly agreeing to automatic renewals of a service. The automatic renewal statute has attracted the attention of the plaintiffs' bar and, like provisions of other consumer-friendly California statutes, appears to be tailor-made for inclusion in class action complaints. Accordingly, companies doing business in California should be aware of the existence, scope, and nuances of this statute to assess potential applicability to any products or services that may qualify as automatic renewals or continuous service offerings. More »

New Jersey Supreme Court Recognizes Broad Common Interest Privilege

On July 21, 2014, the New Jersey Supreme Court issued its opinion in O'Boyle v. Borough of Longport, 94 A.3d 299 (N.J. 2014), adopting a broad application of the common interest doctrine for communications covered by both the attorney-client and attorney work product privileges. In doing so, the Court adopted the formulation of the doctrine previously articulated in LaPorta v. Gloucester County Board of Chosen Freeholders, 774 A.2d 545 (N.J. Super Ct. App. Div. 2001). More »

Access more King & Spalding news More »

Editorial Contacts
Patricia L. Maher
+1 202 626 5504
pmaher@kslaw.com
View Profile »

Carolyn M. Sweeney
+1 202 626 2930
csweeney@kslaw.com
View Profile »

About King & Spalding

Celebrating more than 125 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 800 lawyers in 17 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality and dedication to understanding the business and culture of its clients. More information is available at www.kslaw.com.

Promoting the False Claims Act By Dismissing Meritless Qui Tam Actions

Jeffrey S. Bucholtz, jbucholtz@kslaw.com; Alexander K. Haas, ahaas@kslaw.com

The False Claims Act's qui tam action is a distinctive and atypical form of litigation. Through the qui tam mechanism, Congress created a unique way for the United States to recover for false claims by empowering private persons—relators—to file suit "for the person and for the United States Government." 31 U.S.C. § 3730(b). While allowing private persons to file suit on behalf of the government, Congress ensured through a variety of means that the government would retain substantial control over cases brought in its name. In addition to the government's powers to intervene and take over the prosecution of a qui tam action, to settle such an action, and to limit or even halt discovery that would interfere with a government investigation, the government also has the power to unilaterally "dismiss [a qui tam] action notwithstanding the objections" of a relator. Id. § 3730(c)(2)(A). Yet the most striking thing about the government's dismissal power is how rarely the government exercises it—only a handful of times since the 1986 amendments to the False Claims Act created the modern qui tam action.

The Government's Power To Dismiss A Qui Tam Action

The plain language of the Act imposes no constraint on the reasons why the government may elect to dismiss a qui tam action. Even where the government assumes the relator's allegations to be meritorious, the government may dismiss a qui tam action because the amount of money at stake is too small to justify devoting government resources to the matter,(1) or because pursuit of the action could threaten other government interests.(2)

Nor does the Act contemplate a significant role for the courts in reviewing the government's exercise of its dismissal authority. The dismissal provision does entitle the relator to "an opportunity for a hearing" on the government's dismissal motion, § 3730(c)(2)(A), but it notably does not set forth a standard by which the court is to judge the dismissal motion. The dismissal provision thus contrasts sharply with the Act's settlement provision, which authorizes the government to settle a qui tam action over the relator's objection but only if the court finds that the settlement is "fair, adequate, and reasonable under all the circumstances," id. § 3730(c)(2)(B). The D.C. Circuit thus has concluded that "the function of a hearing when the relator requests one is simply to give the relator a formal opportunity to convince the government not to end the case," with the decision whether to end the case remaining squarely with the government.(3) While courts have used different formulations, all agree that the government's dismissal authority is unfettered and unreviewable or very nearly so.(4)

This unilateral dismissal authority is important because it is essential to the constitutionality of the qui tam mechanism. Allowing private persons to sue on behalf of the government may be constitutional if the government retains authority to control whether or how such suits go forward. But any significant constraint on the government's power to decide that a case brought in its name should not go forward would raise serious separation-of-powers concerns. The Constitution gives the Executive—not private persons—the authority and responsibility to "take Care that the Laws be faithfully executed." U.S. Const., art. II, § 3. As a result, "[t]he decision whether to bring an action on behalf of the United States is therefore 'a decision generally committed to [the government's] absolute discretion.'"(5)

The Government's Reluctance to Dismiss Qui Tam Actions Results In Costs For All Concerned Including the Government and the Public Interest

Why this unilateral dismissal authority has been so infrequently invoked is harder to understand. It has been used only a relative handful of times since the 1986 Amendments to the False Claims Act,(6) and usually in cases that plainly qualified as extraordinary. For example, the government has chosen to dismiss qui tam actions involving classified programs where the government was concerned that continued litigation would risk exposure of sensitive national security information.(7) And the government dismissed a qui tam case claiming that paying then-Senator Obama's salary violated the FCA because he is not a citizen.(8) But other examples are few and far between.

The tiny number of government dismissals looks even tinier when viewed in the context of the recent explosion in qui tam litigation. Over 750 new cases were filed in fiscal year 2013 alone.(9) This explosion of private persons attempting to sue on behalf of the government has left the government itself unable to keep up: there are estimated to be thousands of qui tam actions pending under seal awaiting the government's decision as to whether to intervene,(10) and the government nearly always obtains an extension of the statutory 60-day deadline to make that decision.(11)

Moreover, the simple reality is that many, if not most, declined qui tam actions are meritless. The government intervenes in a small minority of qui tam actions—about 25 percent over the last several years.(12) Yet the vast majority of the $27.2 billion the government has recovered under the FCA since 1986 has come from that small subset of intervened cases.(13) In stark contrast, the much larger universe of declined cases has produced less than $1 billion in recovery. The government's official line is that declining to intervene is not a statement on the merits of a qui tam action, but courts can be forgiven for being skeptical. The explosion in FCA litigation has ensured that most federal judges have seen enough qui tam actions to know that a government declination likely signals that the relator's allegations are flawed factually or legally or both, even if the courts are circumspect enough to generally avoid voicing this common-sense intuition explicitly.(14)

So why isn't the government exercising its dismissal authority to get rid of meritless cases? After all, in certain cases the government has exercised its dismissal power even while conceding that the relator's claims were or may have been meritorious.(15) If dismissing a meritorious qui tam action can be an appropriate exercise of the government's authority, dismissing a meritless one surely must be as well. Bringing an early end to a case that would otherwise subject the defendant, the court, and the government itself to burden and expense without providing any benefit to the government is plainly rational.

The FCA requires the government, when notified of a qui tam case, to investigate the relator's allegations. Sometimes the government is unable to reach a firm conclusion as to the truth of the relator's allegations; sometimes the facts are clear enough but the law is murky. Where the government thinks the relator's claims present a close case—not strong enough to warrant intervention, but strong enough to have the potential to bring some recovery to the Treasury—it makes sense that the government would want the relator to be able to pursue the case. And sometimes the court will push a case forward before the government has finished its investigation, and the government declines because it does not know what to think about the merits of the case. The government may also decline in some cases it believes meritorious, because it expects the relator's counsel to pursue the case and hopes to conserve its own resources. But in many cases, the government conducts a full investigation and concludes with confidence that the case lacks merit. How does it serve the public interest to allow such a meritless case to be pursued in the government's name? Why does the government simply decline to intervene in these cases rather than dismiss them? Surely it is more than the stray "birther" case that warrants dismissal.

The answer appears to be that the Department of Justice, which enforces the FCA, simply does not view its mission as encompassing this sort of gatekeeping function. That choice not to exercise the gatekeeping authority provided by Congress imposes obvious costs on defendants, who have to endure the burden and expense of discovery and litigation in cases that lack merit. To be sure, defendants are often successful, eventually, in winning in declined cases. But they almost never can recover their attorney's fees and thus are left to shoulder substantial expenses even if they win in court. See 31 U.S.C. § 3730(d)(4). The government's refusal to dismiss meritless qui tam cases also burdens the courts in direct and obvious ways. And it burdens the government itself, which incurs costs to monitor the enormous docket of declined qui tam cases and often gets dragged into those cases through discovery.

But a less obvious, but very significant, cost weighs on the government. By failing to exercise its authority to dismiss meritless qui tam actions, the government makes it harder for relators to prevail in borderline cases—where the relator's claim may not be strong enough for the government to bring that claim itself, but is substantial enough to create a potential for recovery for the government. The government may indeed have a rational reason for wanting those cases to go forward despite its own declination. But the government's neglect of its dismissal authority means that meritless declined cases are lumped in with borderline ones, potentially causing courts to view declined cases skeptically as a class.

The Government Should Act as the Gatekeeper Congress Intended and Exercise Its Dismissal Authority

If the government showed itself willing to weed out meritless qui tam actions, courts would be less likely to view a mere declination—as opposed to a declination coupled with a dismissal—as signaling that a case lacks merit. That approach would serve the public interest. It would help unclog court dockets, spare innocent defendants the burdens of pointless litigation, and conserve the government's own resources—enabling the government to focus on worthwhile qui tam actions as well as its myriad other important duties. As the guardian of the public interest, the Department of Justice should embrace this role and vigorously exercise the dismissal authority that Congress provided.

If the Department is unmoved by the plight of courts struggling with congested dockets or defendants forced to bear litigation expenses for no good reason, perhaps the harm to FCA enforcement will resonate instead. Each declination, in a world where declination and intervention are the only options, risks saddling the relator with a presumption that her claim lacks merit. And each meritless and wasteful qui tam action that a court has to hear makes the court more skeptical about FCA cases going forward. The government's abdication of its dismissal authority thus threatens to give the FCA itself a bad name. Congress gave the government the power to dismiss qui tam actions for good reasons, and the Department should take up its responsibility.

(1) Swift v. United States, 318 F.3d 250, 254 (D.C. Cir. 2003).
(2) See, e.g., Ridenour v. Kaiser Hill Co., 397 F.3d 925, 937 (10th Cir. 2005) (government dismissed qui tam action to avoid risk of disclosure of classified information); United States ex rel. Sequoia Orange Co. v. Baird-Neece Packing Corp., 151 F.3d 1139, 1146 (9th Cir. 1998) (government dismissed qui tam action involving citrus marketing program because government had ended that program and sought to end all disputes relating to it).
(3) Swift, 318 F.3d at 253.
(4) Compare Swift, 318 F.3d at 253 (suggesting that the government's dismissal authority is absolute, perhaps with an exception for "fraud on the court"), with Sequoia Orange Co., 151 F.3d at 1145-46 (holding that the government need only show that dismissal is rationally related to a legitimate governmental interest).
(5) Swift, 318 F.3d at 253 (quoting Heckler v. Chaney, 470 U.S. 821, 831 (1985)).
(6) See David Engstrom, Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation Under the False Claims Act, 107 N.W. U. L. Rev. 1689, 1717 & n.89 (2013).
(7) See, e.g., Ridenour v. Kaiser Hill Co., 397 F.3d 925, 937 (10th Cir. 2005) (holding that avoiding an inadvertent disclosure of classified information is a rational basis for dismissing a qui tam case, even if the risk to national security is "minimal"); U.S. ex rel Ray v. Northrop Grumman Corp., 2008 WL 877180 (D. Colo. 2008).
(8) Berg v. Obama, 656 F.Supp.2d 107 (D.D.C. 2009).
(9) See 2013 DOJ False Claims Act Statistics at 2, available at http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf.
(10) See Engstrom, 107 N.W. U. L. Rev. at 1716 & n.86 (stating that approximately 3000 qui tam actions are pending under seal).
(11) 31 U.S.C. § 3730(b)(2); see 2013 DOJ False Claims Act Statistics at 2, supra note 9.
(12) Engstrom, 107 N.W. U. L. Rev. at 1719 (stating that "DOJ intervenes approximately one-quarter-of-the-time").
(13) See 2013 DOJ False Claims Act Statistics, available at http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf. See also Christopher M. Alexion, Open the Door Not the Floodgates: Controlling Qui Tam Litigation Under the False Claims Act, 69 Wash. & Lee L. Rev. 365, 404-05 (2012) ("data about the disposition of qui tam cases supports the idea that the number of frivolous suits is high").
(14) But see, e.g., U.S. ex rel. Jamison v. McKesson Corp., 649 F.3d 322, 331 (5th Cir. 2011) (noting that "the government chose to

intervene against only [] seven defendants" and stating that the "cases against the others presumably lacked merit").
(15) Ridenhour, 397 F.3d at 930; Sequoia Orange, 151 F.3d at 1145-46.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, any of its affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

KING & SPALDING

Business Lit Ledger

Delaware Supreme Court Extends Shareholder Books and Records Inspection Rights to Privileged Internal Investigation Documents

Michael R. Smith, mrsmith@kslaw.com; B. Warren Pope, wpope@kslaw.com; Benjamin Lee, blee@kslaw.com; Alexandra S. Peurach, apeurach@kslaw.com

A recent decision of the Delaware Supreme Court approved granting shareholders the right to inspect privileged and confidential internal investigation materials upon showing "good cause." Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW, No. 614, 2013 (Del. July 23, 2014). Directors and general counsels should be aware of the Wal-Mart decision because it reflects continued heightened scrutiny of the board's role in compliance oversight and subjects sensitive internal investigation documents protected by "the oldest privilege recognized by Anglo-American jurisprudence" to inspection by shareholders seeking to substantiate claims that directors breached their fiduciary duties. The Wal-Mart decision could also trigger an increase in shareholder requests to inspect corporate books and records related to potential regulatory/legal violations.

The Delaware Supreme Court's Holding

Wal-Mart addressed a books and records inspection demand under Delaware law by shareholder Electrical Workers Pension Trust Fund IBEW ("IBEW") seeking to inspect documents pertaining to an alleged bribery scheme involving a Mexican subsidiary of Wal-Mart between 2002 and 2005. The inspection demand followed an April 2012 New York Times article reporting that Wal-Mart executives disregarded an initial investigation revealing significant problems, instead turning the investigation over to the general counsel of the Mexican subsidiary, who was himself implicated in the initial review. According to IBEW's demand letter, its purpose for the inspection demand was to investigate possible mismanagement and/or breaches of fiduciary duty in connection with the alleged bribery scheme and the Company's response, and to determine whether pre-suit demand on the Board would be futile as part of a derivative lawsuit to recover damages on behalf of Wal-Mart. Wal-Mart produced hundreds of thousands of pages of documents in response to the demand, but redacted or otherwise declined to provide documents that it determined were not "necessary and essential" to the purposes of IBEW's demand or that were protected by the attorney-client privilege and/or the work product doctrine.

IBEW brought an action pursuant to Title 8, Section 220 of the Delaware Code to enforce shareholder inspection rights with respect to the withheld documents. The Court of Chancery ordered Wal-Mart to produce certain internal documents concerning what its directors and officers knew about the bribery allegations, including officer-level documents never provided to the board and documents protected by the attorney-client privilege and work product doctrine. Wal-Mart appealed, arguing that the scope of the production ordered by the Court of Chancery was not "necessary and essential" to the proper purposes of IBEW's demand, the standard for discovery in Section 220 actions.

The Delaware Supreme Court rejected Wal-Mart's arguments and affirmed the Court of Chancery's grant of inspection rights. In doing so, the Supreme Court ruled that officer-level documents never before presented to the Board were "necessary and essential" to IBEW's demand, because the stated purposes of the demand were broader than simply determining whether a demand on the Board would be futile, and included an investigation of the underlying bribery scandal and how the ensuing investigation by the Company was handled. The Supreme Court affirmed the ruling that the officer-level documents were "necessary and essential to determining whether and to what extent mismanagement occurred and what information was transmitted to Wal-Mart's directors and officers," because key officers were involved in the Company's investigation of the bribery allegations.

More critically, the Delaware Supreme Court adopted an exception to the attorney-client privilege—the so-called "Garner doctrine." Garner v. Wolfinbarger, 439 F.2d 1093 (5th Cir. 1970). The Garner doctrine is named for a 1970 decision of the Fifth Circuit Court of Appeals, which recognized an exception to the attorney-client privilege, allowing shareholders alleging breach of fiduciary duty claims against corporate directors and officers to invade a corporation's attorney-client privilege upon a showing of "good cause." The Delaware Supreme Court's adoption of Garner in Wal-Mart means that the attorney-client privilege is now subject to an exception in Delaware where shareholders purporting to act for the benefit of the company can show a need for otherwise privileged information to substantiate a claim that directors or officers breached their fiduciary duties. The Supreme Court did observe, however, that the exception is "narrow, exacting, and intended to be very difficult to satisfy."

In upholding the lower court's application of the Garner doctrine in Wal-Mart, the Delaware Supreme Court found that the privileged communications surrounding the internal investigations were "necessary and essential" to IBEW's demand because IBEW sought information concerning the Board's handling of the alleged bribery scandal, whether an internal cover-up of the scandal occurred, and what information was shared with the Board regarding the scandal. IBEW demonstrated "good cause" for the disclosure of privileged documents by Wal-Mart because IBEW had shown an "obviously colorable" claim for breach of fiduciary duty by certain officers and perhaps the board, and the information needed for IBEW to assert that claim was not currently available from other sources. As such, the Supreme Court held that "the record supports the Court of Chancery's conclusion that the documentary information sought in the Demand should be produced by Wal-Mart pursuant to the Garner fiduciary exception to the attorney-client privilege."

Implications of the Decision

While recognition of the Garner exception to the attorney-client privilege was perhaps not surprising – several Delaware lower court decisions had followed Garner – the decision to apply Garner in the context of a pre-litigation books and records inspection demand caught many observers of Delaware law off-guard. Some commentators had predicted that the Delaware high court would only follow Garner in the discovery phase of litigation after a court had found that the plaintiff's allegations of wrongdoing were sufficient to survive a motion to dismiss. Instead, the Supreme Court embraced application of Garner to pre-litigation shareholder books and records inspection requests where a shareholder only needs to claim he is investigating certain specified potential "wrongdoing."

The endorsement of Garner in the books and records inspection context, as well as the Delaware Supreme Court's approval of far-reaching inspection requests (which sought documents generated over a seven-year period), could subject Delaware corporations to an increase in both costly inspection requests as well as derivative litigation against boards. A majority of derivative suits claiming breach of fiduciary duty by corporate boards are dismissed prior to any discovery under Delaware's strict pleading requirements governing attempts to establish that pre-suit demand on the board should be excused as futile. With the potentially broader access to internal corporate documents portended by Wal-Mart, shareholder plaintiffs may be able to plead demand futility with greater particularity, and could both bring a greater number of derivative suits and see more such suits survive a motion to dismiss. The extent to which shareholder plaintiffs will be able to successfully rely on Wal-Mart to obtain privileged documents will depend on whether courts honor Wal-Mart's admonition that the Garner exception should be construed as "narrow, exacting, and . . . very difficult to satisfy."

There is reason to believe that Wal-Mart's holding may be limited to the particular and compelling facts of that case. First, Wal-Mart arose from specific allegations of criminal and other illegal conduct, which Garner held was a factor courts should consider in deciding whether to require the disclosure of privileged documents. Second, the Delaware Supreme Court noted that, under Garner's test, courts should consider whether shareholders have stated an "obviously colorable" claim, as opposed to "blindly fishing" for information. The shareholders in Wal-Mart were in the unique position of being able to rely on The New York Times article describing in great detail the alleged bribery scheme and the Company's allegedly inadequate response. In addition, Wal-Mart's own public statements suggested real concerns about the legality of its conduct in Mexico. In most cases, shareholders will not have that luxury. In cases involving allegations of less weight and substantiation, courts may not be as inclined to order the production of privileged materials or permit broad inspection rights.

Nevertheless, Wal-Mart serves as a sobering reminder that privileges are not absolute and that the board's role in overseeing corporate compliance will continue to come under greater scrutiny by shareholders and the courts. Directors, officers, and their counsel should bear in mind the risk that even privileged communications and attorney work product related to internal investigations of potential legal violations may one day have to be disclosed to shareholders. Accordingly, such materials should be prepared with that risk in mind, especially after Wal-Mart. In addition, following Wal-Mart, boards should expect more frequent shareholder litigation claiming that the board breached fiduciary duties by failing to provide appropriate oversight of legal compliance where violations of law occur in some corner of the company. To address the new reality of greater board accountability for corporate legal compliance, corporate boards should engage in periodic assessments of their companies' internal control structure over legal compliance to assure that controls are adequately designed and operate effectively to provide management and the board reasonable assurance of full legal compliance.

The opinion in the Wal-Mart case can be found here.

King & Spalding

Business Lit Ledger

Stopping the DOJ at the Border? A New Defense to the Reach of Federal Extraterritorial Criminal Action

Grace M. Rodriguez, grodriguez@kslaw.com; Wendy W. H. Waszmer, wwaszmer@kslaw.com; Carolyn M. Sweeney, csweeney@kslaw.com

In a one-day Department of Justice Antitrust Division takedown last September, nine international companies based outside the United States pled guilty to criminal antitrust violations and agreed to pay more than $740 million in fines. In our increasingly globalized world, federal law enforcers have investigated and prosecuted numerous foreign corporations with limited presence in the United States for violations of U.S. criminal laws. Whether in cartel, corruption, or other international cases, foreign companies and their employees have chosen to submit to U.S. jurisdiction, sometimes facing hundreds of millions of dollars in fines and jail time.

With this background, it may come as a surprise to American corporations that their foreign counterparts—joint venture or business partners—may be able to successfully challenge U.S. criminal charges on a technical ground: failure to properly serve charges. The few foreign corporations to have attempted this argument have met with moderate success because the Federal Rules of Criminal Procedure do not address service of process overseas. Although the law on this topic is inconsistent, it is abundantly clear that American companies may stand alone in court if they are ever charged with criminal wrongdoing in conjunction with a foreign business relationship because their foreign partner may be beyond the reach of service of process by the United States.

Serving Charges in International Criminal Enforcement

The Department of Justice and other U.S. law enforcers have made international enforcement, i.e., prosecution of non-U.S. companies and individuals who violate U.S. criminal law, a priority. This, coupled with a broadening range of companies at risk in anti-corruption, antitrust cartel, and other investigations, has led to robust investigations of foreign entities. However, the procedural rules governing federal criminal litigation do not address the seemingly simple issue of how charges are served on companies with limited or no presence in the U.S.

Rule 4 of the Federal Rules of Criminal Procedure requires that prosecutors serve charges on corporate defendants, specifying that the summons (1) be delivered to someone able to receive service ("delivery requirement"), and (2) be mailed to the organization's last known address ("mailing requirement"). Fed. R. Crim. P. 4(c)(3)(C). For U.S. companies, this rule presents few barriers to service. However, foreign companies present in the U.S. only through a subsidiary or a joint venture may have no officers, agents, or "last known address" in the U.S., making service difficult.

Challenges to Service of a Summons

To counter challenges based on service by foreign corporate defendants, the U.S. government has relied on principles of agency and alter ego to justify its service of foreign corporations through service on U.S. affiliates or representatives. The law remains largely unsettled regarding how to establish service on an agent or on an alter ego. In a few instances, prosecution has been stalled because the government failed to demonstrate proper service, and in one instance, this delay led to a dismissal of all charges based on an inability to serve the foreign defendant. Delay is a significant complication for prosecutors striving to bring cases before juries while witnesses are fresh, evidence is readily available, and perceived harm is in the public's consciousness. The remaining alternative is to seek service via treaties with foreign nations, which raises its own complexities.

Agency Principles

Fed. R. Crim. P. 4 references agency law principles in permitting service on a "managing or general agent" within the U.S. to satisfy the delivery requirement. In two recent cases, courts looked to federal agency law to determine whether service on a U.S. subsidiary as an agent of its foreign parent was sufficient, and reached different results.

In United States v. Kolon Industries, Inc., the court drew upon basic agency principles, namely, that the "mark of an agent is the ability, whether actual or apparent, to contract in the name of the principal and thereby bind him." 926 F. Supp. 2d 794, 810 (E.D. Va. 2013). There, the court held service was insufficient because the U.S. subsidiary was not an agent of its foreign parent—it did not bind its parent when making contracts. In United States v. Pangang Group Co., the court applied the Ninth Circuit's agency test, considering (1) whether the services rendered by the U.S. subsidiary are of such importance that, if the parent had no U.S. representative, it would undertake similar services itself, and (2) whether the parent exercises control over its U.S. subsidiary. 879 F. Supp. 2d 1052, 1058–59 (N.D. Cal. 2012). Finding the U.S. subsidiary's functions integral to its Chinese parent's business and parental control of its subsidiary, the court held that service on the subsidiary satisfied the delivery requirement.

Courts agree that the government can comply with the mailing requirement by serving an agent of the foreign corporation, but that is all courts agree on in this area. The formulations courts use of agency law, and the factors considered relevant to the analysis are quite different. Moreover, agency arguments only go so far—they have been applied only to determine completion of the delivery requirement, not the mailing requirement.

Alter Ego Analysis

As an alternative to the agency theory, the U.S. government has also argued that serving a U.S. alter ego of a foreign company meets both the delivery and mailing requirements. The five federal courts to consider this have taken inconsistent approaches, some applying federal law and some state law. The key factor for each was whether the U.S. entity and its foreign parent maintained (or failed to maintain) corporate formalities justifying separate treatment. Notably, facts that tend to prove agency (e.g., agent independence) often cut against the alter ego theory, and vice-versa.

In three of the five recent cases, courts applied federal law to determine whether a U.S. company is an alter ego of its foreign parent. The decisions echo "veil piercing" analyses. Applying the Eleventh Circuit's multi-factor test, one court determined that a U.S. company was the alter ego of its parent because the companies held themselves out as one company, shared a website, and shared common directors. United States v. Public Warehousing Co., No. 09-CR-490, 2011 WL 1126333, at *6–7 (N.D. Ga. Mar. 28, 2011). Another court, which focused on the subsidiary's contacts with the forum and on whether the subsidiary was a mere conduit for its parent's activities, determined that a U.S. subsidiary was the alter ego of its parent in part because the companies shared directors and the parent's employees held themselves out as employees of the U.S. subsidiary, including when contacting other U.S. companies. United States v. Chitron Electronics Co., 668 F. Supp. 2d 298, 305–06 (D. Mass. 2009). A third court applied the Ninth Circuit's two-prong test and found that a U.S. subsidiary was not the alter ego of its foreign parent despite their common directors, because the two lacked a unity of interest and there was no showing of fraud or injustice in the corporate structure. Pangang, 879 F. Supp. 2d at 1066.

The remaining two courts applied state law in assessing whether the government properly served a foreign parent through its U.S. alter ego. Under state law, a subsidiary is generally an alter ego of its parent if: (1) the corporation is a mere instrumentality of its parent with no independent legal existence, and (2) the corporate structure has been used to perpetrate fraud or injustice. In both cases, the courts found that subsidiaries were not alter egos because the companies maintained corporate formalities and were sufficiently capitalized. Service through the subsidiaries was therefore insufficient. Kolon, 926 F. Supp. at 817 & n.23; United States v. Alfred L. Wolff GMBH, No. 08-cr-417, 2011 WL 4471383, at *5–6 (N.D. Ill. Sept. 26, 2011). This alter ego finding was made in both cases even though in both cases the parent and subsidiary had common board members and the facts were sufficiently developed to charge both corporations as conspirators.

Improper Service: Dismissal or Delay?

Courts are hesitant to dismiss indictments based on lack of proper service, although one court has done so without prejudice on a motion from the government for inability to serve the defendant. Alfred L. Wolff, No. 8-cr-417, ECF. No. 199 (June 19, 2012). Part of this reluctance may be explained by the lack of clarity as to whether both delivery and mailing requirements must be met. Some courts view only the delivery requirement as necessary to effectuate service, while others deem completion of both the delivery and mailing requirements as necessary. Compare Kolon, 926 F. Supp. 2d at 801 (only delivery requirement necessary) and United States v. Dotcom, No. 12-cr-3, 2012 WL 4788433, at *1 (E.D. Va. Oct. 5, 2012) (same) with Pangang, 879 F. Supp. 2d at 1065–66 (mailing requirement necessary). In addition, courts are plainly concerned about creating barriers to prosecution that enable corporations to evade U.S. jurisdiction by "purposefully failing to establish an address here." Kolon, 926 F. Supp. 2d at 801. Nonetheless, failure to serve a defendant halts proceedings and stalls trials. In Pangang, the court ordered prosecutors to pursue non-rules based means of service on foreign defendants, including via Mutual Legal Assistance Treaties (MLATs), 879 F. Supp. 2d at 1069, and the government did so. For many reasons, including the fact that use of an MLAT requires assent by the treaty partner, this difficult, time-consuming alternative is not preferred by prosecutors and may not work for all countries or for all alleged crimes on which the indictments are based.

Conclusion: A Note of Caution for American Corporations

Service of criminal charges on foreign corporations is a surprisingly unsettled area of law and courts have struggled to balance the technical requirements of Rule 4 with the practical implications of allowing foreign companies to evade prosecution for crimes with a U.S. nexus. Whether the government can establish service using agency or alter ego theories is a highly fact-specific inquiry, and the facts that establish one avenue may not suffice for the other. The most important point for U.S. companies is that foreign business partners facing U.S. criminal investigations may not have sufficient contacts with the U.S. to be brought before an American court, even if their contacts are sufficient to establish the elements of the offense. Those same foreign organizations that refuse to surrender to the power of federal courts may not be compelled to appear in U.S. court.

The law regarding the exposure of foreign corporations to litigation in U.S. courts is still developing, which has led to surprising results. In addition to potentially successful service-related defenses asserted by foreign corporate defendants in criminal cases, unsettled issues of personal jurisdiction and other threshold questions are playing a large part in important cases involving foreign corporations, including multi-district litigation regarding LIBOR manipulation and aluminum warehousing. Recent trends suggest that foreign corporations may be able to stay out of U.S. courts by calling on principles of procedure and jurisdiction; defenses undoubtedly unavailable to their American counterparts and business partners.

California's Automatic Renewal Statute Creates Risk of Class Action Litigation

David L. Balser, dbalser@kslaw.com; Claire Carothers Oates, coates@kslaw.com; Lawrence A. Slovensky, lslovensky@kslaw.com

California's General Assembly enacted a statute in 2009 that purports to prevent California residents from unknowingly agreeing to automatic renewals of a service. The automatic renewal statute has attracted the attention of the plaintiffs' bar and, like provisions of other consumer-friendly California statutes, appears to be tailor-made for inclusion in class action complaints. Accordingly, companies doing business in California should be aware of the existence, scope, and nuances of this statute to assess potential applicability to any products or services that may qualify as automatic renewals or continuous service offerings.

Scope of Act and Statutory Exceptions

California's automatic renewal statute became effective on December 1, 2010.(1) The statute applies to goods and services sold to consumers, which the law defines as "any individual who seeks or acquires, by purchase or lease, any goods, services, money, or credit for personal, family, or household purposes."(2) The statute further defines automatic renewal as "a plan or arrangement in which a paid subscription or purchasing agreement is automatically renewed at the end of a definite term for a subsequent term."(3) The statute then defines "continuous service" as "a plan or arrangement in which a subscription or purchasing agreement continues until the consumer cancels the service."(4, 5)

Disclosure Terms

The automatic renewal statute's first substantive provision requires any automatic renewal offer to be disclosed in a "clear and conspicuous manner."(6) The statute specifically defines "clear and conspicuous manner" as

> in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from the surrounding text of the same size by symbols or other marks, in a manner that clearly will cause attention to the language.(7)

For audio disclosures, the statute defines "clear and conspicuous" as "in a volume and cadence sufficient to be readily audible and understandable."(8)

Under the statute, automatic renewal offer terms or continuous service offer terms also must be made "in visual proximity," or in the case of an audio disclosure, in "temporal proximity" to the request for consent to the offer.(9)

Affirmative Consent

The statute further requires that the company obtain "affirmative consent" from the consumer before charging a credit or debit card or the consumer's account.(10) While the statute does not define "affirmative consent," court decisions that address the evidence required to establish that a consumer agreed to the terms of the contract suggest that affirmative consent requires some showing that the consumer took action intended to convey agreement, such as clicking an "I agree" box, as opposed to merely having access to terms and not objecting.(11) Thus, the automatic renewal statute appears to require the selling company to obtain evidence that the consumer took action expressing knowledge of and agreement to the terms of the automatic renewal offering before the company can charge the consumer's credit or debit card.

Notice of Retainable Cancellation Policy

Under Section 17602(a)(3), the company must provide to the consumer an acknowledgment that includes the automatic renewal or continuous service offer terms, cancellation policy, and information regarding how to cancel.(12) The Section 17602(a)(3) acknowledgement may be provided to the consumer after completion of the initial order.(13)

Importantly, this acknowledgment must be provided "in a manner that is capable of being retained by the consumer."(14) The Section 17602(a)(3) retainable cancellation policy also must inform the consumer of the "cost-effective, timely, and easy-to-use mechanism for cancellation" that the company must establish and support under Section 17602(b).(15) The statute states that use of a toll-free telephone number, e-mail, or in some circumstances postal address would comply with this requirement, but other cancellation mechanisms also may be permitted.(16)

If the automatic renewal or continuous service offer includes a free trial, the company must disclose in the retainable cancellation policy how to cancel the trial and allow the consumer to cancel the trial before paying for the goods and services offered.(17)

Material Changes to Terms of Service

Section 17602(c) requires that the company must provide "clear and conspicuous" notice of a material change to the terms of the offer and provide information regarding how to cancel prior to implementation of the change.(18) Clear and conspicuous notice has the statutory definition provided in Section 17601.(19) Like the retainable cancellation notice of Section 17602(a)(3), notification of how to cancel in the event of material changes to the terms of service must be provided in a manner that is capable of being retained by the consumer.(20)

Enforcement Mechanisms

The statute provides that all "available civil remedies that apply to a violation of this article may be employed." By referencing available civil remedies, the statute allows plaintiffs to assert claims under Cal. Bus. & Prof. Code Section 17200. Section 17603 also states that if a business "sends any goods, wares, merchandise, or products to a consumer" under a continuous service or automatic renewal agreement but fails to comply with the substantive requirements of Section 17602, the goods are deemed to be "an unconditional gift to the consumer, who may use or dispose of the same in any manner he or she sees fit without any obligation whatsoever on the consumer's part to the business, including, but not limited to, bearing the cost of, or responsibility for, shipping any goods, wares, merchandise or products to the business." This provision appears designed to allow a plaintiff who has received goods under a continuous service agreement or automatic renewal arrangement to argue that any amounts paid for the goods should be refunded because of the deemed unconditional gift. Significantly, this provision only refers to "goods" and not to "services."

Safe Harbor For Good Faith Actions

Section 17604(b) describes a potential safe harbor defense for companies that attempt to comply with the provisions of the article "in good faith." The statute does not provide further description of this potential safe harbor, so the parameters of what actions might constitute "good faith" remain unclear. Nonetheless, the existence of a potential defense based on good faith compliance with the statute further demonstrates why companies should be aware of the statute and should implement policies to conform therewith.

Standing and Application to Non-Californians

The statute provides that "[i]t shall be unlawful for any business making an automatic renewal or continuous service offer to a consumer in this state" to take the actions enumerated in Section 17602.(21) (emphasis added). The limited case law addressing this provision establishes precedent for the position that the statute does not apply to transactions with non-California residents.(22)

California Class Action Litigation Relating to the Automatic Renewal Statute

Several features of California's automatic renewal statue make it attractive to the class action plaintiffs' bar. The statute includes provisions such as the requirement of conspicuous disclosure of terms, receipt of affirmative consent, and provision of retainable cancellation policies that companies might not regularly use or obtain if unaware of the statute's technical requirements. The statute's "unconditional gift" provision also allows a class action plaintiff to allege damages based on a theory that all revenue from the challenged offering should be disgorged to the class.

Not surprisingly, these features have led to the filing of several class action lawsuits in California. There have been at least eight class actions filed under the statue since 2011 and plaintiffs have invoked the statute against a wide range of company offerings, including software purchases, cellphone charges, streaming music services, smartphone applications and online storage services. There do not appear to be any significant judgments or settlements to date in cases in which the statute has been invoked. Nonetheless, the plaintiffs' class action bar is focused on this statute and we expect additional suits to be filed.

Conclusions

California's automatic renewal statute contains requirements that are technical, specific, and can be overlooked by unwary companies. Some of the defendants who have been named in early class action lawsuits have been able to defeat or limit claims based on the statute's language, the existence of mandatory arbitration clauses, standing requirements, and other general defenses to class certification. Nonetheless, companies that sell automatically renewing offerings in California should closely review the requirements of the statute and consider how best to comply.

(1) Cal. Bus. & Prof. Code § 17606.
(2) Cal. Bus. & Prof. Code § 17601(d).
(3) Id. at § 17601(a).
(4) Id. at § 17601(e).
(5) The Act expressly carves out several types of offerings that otherwise would fall within these definitions (Id. at § 17605), including offerings from businesses regulated by the California Public Utilities Commission, Federal Communications Commission, or the Federal Energy Regulatory Commission (Id. at § 17605(b)); businesses regulated by the California Department of Insurance (Id. at § 17605(c)); alarm company operators (Id. at § 17605(d)); banks, bank holding companies, credit unions, "or other financial institution[s]" that are licensed under state or federal law (Id. at § 17605(e)); and service contract sellers and service contract administrators regulated by California's Bureau of Electronic Appliance Repair (Id. at § 17605(f)).
(6) Id. at § 17602(a)(1).
(7) Id. at § 17601(c).
(8) Id.
(9) Id.
(10) Id. at § 17602(a)(2).
(11) See, e.g., Specht v. Netscape Comms., 306 F.3d 17, 34 (2d. Cir. 2002) (applying California law).
(12) Cal. Bus. & Prof. Code § 17602(a)(3).
(13) Id. at § 17602(d)(1).
(14) Id. at § 17602(a)(3).
(15) Id.; see also id. at § 17602(b).
(16) Id. at § 17602(b).
(17) Id. at § 17602(a)(3).
(18) Id. at §§ 17602(c); 17602(d)(2).
(19) Id. at § 17601(c).
(20) Id. at § 17602(c).
(21) Id. at § 17602(a).
(22) Significantly, however, other statutes contain restrictions on how automatic renewal offerings must be disclosed. Several other states, including Colorado, Connecticut, Florida, Georgia, Hawaii, Illinois, Louisiana, North Carolina, and Oregon have enacted restrictions that apply to at least some automatic renewal offerings.

New Jersey Supreme Court Recognizes Broad Common Interest Privilege

Kevin M. Dinan, kdinan@kslaw.com

On July 21, 2014, the New Jersey Supreme Court issued its opinion in O'Boyle v. Borough of Longport, 94 A.3d 299 (N.J. 2014), adopting a broad application of the common interest doctrine for communications covered by both the attorney-client and attorney work product privileges. In doing so, the Court adopted the formulation of the doctrine previously articulated in LaPorta v. Gloucester County Board of Chosen Freeholders, 774 A.2d 545 (N.J. Super Ct. App. Div. 2001).

The O'Boyle case arose out of a request for public records pursuant to the New Jersey Open Public Records Act ("OPRA"). Among the public records sought were a joint strategy memo and a compendium of documents that were sent to an attorney for the Borough of Longport by a private attorney representing residents and a former member of the Borough's planning and zoning board in litigation brought by O'Boyle. The documents were exchanged so the two attorneys could consider whether to cooperate in the defense of existing and anticipated litigation brought by O'Boyle, a Longport resident who had a history of suing the Borough. The Borough refused to provide these documents to O'Boyle, claiming they were privileged, and O'Boyle then filed suit to compel their production.

The trial court dismissed the complaint on the grounds the requested documents were not public records subject to the OPRA or the common law right of access. The Appellate Division assumed the records were public records, but held they were privileged work product and that the common interest doctrine applied to the sharing of information between the private attorney and the Borough attorney.

In affirming the Appellate Division, the New Jersey Supreme Court rejected more conservative formulations of the common interest doctrine, such as requiring complete identity of interests with those to whom the privileged information is disclosed, a threat of actual litigation, or "that the common interest be legal rather than purely commercial." Instead, the Court held that the common interest doctrine in New Jersey applies "to communications between attorneys for different parties if the disclosure is made due to actual or anticipated litigation for the purpose of furthering a common interest, and the disclosure is made in a manner to preserve the confidentiality of the disclosed material and to prevent disclosure to adverse parties."

The Court emphasized that the interests of the parties sharing the information do not need to be identical, all that is required is a common purpose. For example, the sharing of information does not have to occur in connection with a single legal action to remain privileged. Sharing of information between attorneys who have a common adversary will be protected even if the actual or anticipated litigation is not the same. The Court also held that the doctrine is not limited to communications between counsel. As long as there is a common interest, communications between counsel for one party and the representative of another party will preserve the privilege. Moreover, the Court held that the doctrine is broad enough to cover the sharing of privileged information between attorneys who share a common purpose when the intent of the communications is to decide whether to enter into a common interest arrangement.

The Court did not address whether protection under the common interest doctrine requires a written agreement, and written agreements are generally not required. However, having a written common interest or joint defense agreement can assist in demonstrating the existence of the common interest, provide evidence of those actions taken to preserve the confidentiality of the disclosed information, and help avoid later disputes between the parties exchanging the information. Points that should be included in a common interest agreement are:

• The identity of the subject matter covered by the agreement;
• A description of the common interest that the parties share;
• Agreement that the information shared between the parties shall remain privileged and that it shall not be disclosed to others without the consent of all parties to the agreement;
• Agreement that all parties to the agreement will take actions to ensure that the disclosed information remains confidential;
• Agreement that the shared information shall be used only for those purposes identified in the agreement;
• Procedures to be followed if any party to the agreement receives a request or demand for the shared information;
• Agreement that any privileged information provided under the agreement will be returned upon the request of the party who provided the information; and
• Whether the common interest protection may be asserted by one party to the agreement against another party if they later become litigation adversaries.

The parties to the agreement may also want to consider a provision that counsel to the parties shall not be disqualified from representing their current client in subsequent litigation or proceedings between the parties as a result of the agreement or receipt of any information under the agreement.

The opinion in the O'Boyle case can be found here.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, any of its affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

Client Victories

King & Spalding Wins Dismissals for Omnicare in Separate FCA Cases in Georgia and New York, Recovering Partial Defense Costs

Phyllis B. Sumner, psumner@kslaw.com; Michael E. Paulhus, mpaulhus@kslaw.com; Wendy W. H. Waszmer, wwaszmer@kslaw.com

In May and August of this year, King & Spalding achieved complete victory for Omnicare, Inc., in two separate False Claims Act actions brought by the same qui tam relator. The first action filed in the Northern District of Georgia, U.S. ex rel. Fox Rx., Inc. v. Omnicare, Inc., No. 1:11-cv-962-WSD (N.D. Ga.), involved allegations of improper submission of prescriptions under Medicare Part D, including prescriptions for atypical antipsychotic drugs ("AAP"). Relator made allegations relating to more than 300 million prescription claims. In successive rounds of motions practice, the Court dismissed counts of the Second and Third Amended Complaints, reducing the case to 13,000 alleged false claims. After intensive fact and expert discovery, Omnicare moved for summary judgment on the remaining counts, which the Court granted on May 23, 2014, ruling the relator could not show that Omnicare acted with the requisite intent to violate the FCA. The Court noted that relator had presented no direct evidence that dispensing pharmacists who filled prescriptions had access to patient diagnostic information, or that any prescription was off-label. The Court further held that even if the record had shown dispensing pharmacists had access to patients' diagnoses, the relator could not meet a "reckless disregard" or "deliberate indifference" standard for establishing knowledge. The diagnoses alone would not establish whether a particular prescription was for a medically accepted indication. In granting Omnicare's motion for summary judgment, the Court noted relator conceded there were only 145 off-label prescriptions for 47 patients, despite its prior claim of "thousands" of prescriptions. The Court awarded costs to Omnicare.

Upon King & Spalding's motion for attorney's fees and expenses, the relator waived appeal and agreed to pay Omnicare $100,000 in costs. The ruling was an important victory not only for Omnicare but also for King & Spalding's other pharmacy clients, as it created important precedent confirming that pharmacies do not have a duty to evaluate whether prescriptions are prescribed for off-label use and thus whether they are covered by the Medicare Part D program.

In the second action filed the Southern District of New York, U.S. ex rel. Fox Rx., Inc. v. Omnicare, Inc., No. 1:12-cv-00275-DLC (S.D.N.Y.), King & Spalding won dismissal of Fox's entire FCA action prior to discovery. Fox alleged in this case that Omnicare caused the submission of false claims by (1) failing to substitute generic drugs in place of brand products, and (2) dispensing drugs with obsolete National Drug Codes, which relator assumed reflected expired drugs. On August 19, 2014, the Court granted Omnicare's motion to dismiss, and dismissed all claims with prejudice. The Court held that the relator had primarily relied on an implied certification theory in alleging the submission of false claims; and it found that, of the four federal regulations cited by the relator, three involved no condition of payment and even though a fourth regulation required an express certification of truthfulness the relator had not adequately alleged a false certification. In doing so, the Court created further useful FCA precedent applying the Second Circuit's decision in Mikes v. Straus, 274 F.3d 687 (2d Cir. 2001).

KPMG's Motion for Summary Judgment Granted in Federal U.S. Virgin Islands Tax Shelter Malpractice Case

Kevin M. Dinan, kdinan@kslaw.com

On June 6, 2014, King & Spalding obtained summary judgment on behalf of KPMG LLP in a tax shelter malpractice case in which the plaintiffs alleged fraud, negligent misrepresentation, negligence, breach of fiduciary duty, and federal RICO claims. The case is one of more than 25 tax shelter malpractice matters King & Spalding has handled for KPMG.

In granting summary judgment, the court found that the plaintiffs, who had engaged in a tax strategy known as the Short Option Strategy ("SOS"), knew or should have known that the IRS would disallow the tax benefits associated with the SOS transaction. Among the factors the court cited as evidence that the plaintiffs should have known the tax benefits would not be allowed were the plaintiffs' tax-driven motivations, their business sophistication, and the fact that the benefits were too good to be true. The court held that these "danger signals" precluded the plaintiffs from establishing the justifiable reliance necessary to pursue their state law fraud and negligent misrepresentation claims, as well as their federal RICO claims. The court also held that the plaintiffs' negligence and breach of fiduciary duty claims should be dismissed because KPMG's advice was not the proximate cause of their claimed losses. Rather, the proximate cause was that their "own objectives for utilizing SOS were primarily tax-driven."

The case is DDRA Capital, Inc. v. KPMG LLP, No. 04-0158 (D. V.I.).

A copy of the summary judgment order can be found here.

KING & SPALDING

Client Alert

Insurance Coverage & Recovery Practice Group

September 3, 2014

#Insurance Coverage for Emerging Social Media Risks

There are 1.3 billion people on Facebook, half a billion "tweets" every day, and countless other ways to communicate that did not even exist five years ago. In response to this social media revolution, smart companies are increasingly unleashing social media strategies to reach their customers, while their employees are using social media to "stay connected" twenty-four hours a day.

Despite the many ways in which social media can improve a business's bottom line, social media also creates the potential for new types of liability. From discrimination claims when hiring decisions are based on information gleaned from an applicant's Facebook page, to vicarious liability for cyber-bullying or defamation, social media in the workplace presents new risks that were unheard of just a few years ago. In response to these new risks, the insurance industry is still in the process of creating new products—and policy exclusions. Further, there are few court decisions to guide risk managers on whether social media claims are covered under the traditional suite of commercial general liability ("CGL"), errors & omissions ("E&O"), and employment practices liability ("EPL") policies, not to mention newer media liability policies that purportedly were designed with social media exposures in mind.

This client alert outlines several types of risks that employers increasingly face due to the use of social media in the workplace, and discusses various insurance coverage issues that companies and their risk managers should consider to reduce their exposure.

Social Media Policies, Labor & Employment Liabilities, and Potential Gaps in Coverage

The recent explosion in the use of social media in the workplace has created a labor and employment liability minefield. For example, managers that "friend" their direct reports may inadvertently expose themselves and their company to harassment claims, and hiring decisions based on information gleaned from Facebook pages can lead to discrimination claims—and in some states, statutory liability. Standard employers' liability insurance policies increasingly contain "social media" exclusions that bar or limit coverage for these types exposures, highlighting the need for in-house counsel, risk managers, and human resource managers to work together to

For more information, contact:

Meghan H. Magruder
+ 1 404 572 2615
mmagruder@kslaw.com

Anthony P. Tatum
+ 1 404 572 3519
ttatum@kslaw.com

Shelby S. Guilbert, Jr.
+ 1 404 572 4697
sguilbert@kslaw.com

Robert D. Stonebraker
+ 1 404 572 3536
rstonebraker@kslaw.com

Nicholas G. Hill
+ 1 404 572 3503
nhill@kslaw.com

King & Spalding
Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

www.kslaw.com

create effective corporate social media policies and training programs to minimize these risks.

In crafting social media policies, companies are understandably focused on finding ways to protect their online reputation by policing the content on their social media pages. But when companies overreach and terminate employees based on their online communications, or innocently implement "zero-tolerance" policies for certain types of online communications, they could risk running afoul of labor laws like the National Labor Relations Act ("NLRA").

Section 7 of the NLRA states that "employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection . . ." 29 U.S.C. § 157. Correspondingly, Section 8 of the Act prohibits employers from engaging in unfair labor practices, among which is "to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7." *Id.* § 158. A recent decision by the National Labor Relations Board ("NLRB") illustrates the potential pitfalls that may arise out of restricting employees' online communications.

In *Hispanics United of Buffalo, Inc.*, Case 03–CA–027872, 359 N.L.R.B. No. 37, slip op. (Dec. 14, 2012), an employee who worked for an organization that helped victims of domestic violence posted that one of her co-workers felt that she and other employees did not work hard enough to help their clients, and that the co-worker was going to complain to management. *Id.* at 1–2. In response, several additional co-workers commented on the posts, and "objected to the assertion that their work performance was substandard." *Id.* at 2. The co-worker who was the subject of the posts then reported them to her supervisor and complained of "bullying and harassment." *Id.* Because the organization had a zero-tolerance policy toward such behavior, all of the co-workers who posted were fired. *Id.* When the termination decision was challenged, however, the NLRB held that because the employees "were taking a first step towards taking group action to defend themselves against the accusations they could reasonably believe [the employee] was going to make to management," they were engaging in concerted activity protected by Section 8 of the Act. *Id.* The NLRB's decision highlighted that a crucial distinction is whether the employees' use of social media is a vehicle for concerted activity or whether it is simply an expression of dissatisfaction. The former is protected under the Act, while the latter is not.

In addition to addressing termination based on employees' use of social media, the NLRB also has recently issued decisions concerning the legality of companies' social media policies that purport to bar employees from making defamatory statements about their employer. *See Costco Wholesale Corp.*, Case 34–CA–012421, 358 NLRB No. 106, slip op. (Sept. 7, 2012); *Karl Knauz Motors*, Case 13-CA-046452, 358 NLRB No. 164, slip op. (Sept. 28, 2012). Under these decisions, the NLRB has held that social media policies cannot be so broad as to result in a policy that "would reasonably tend to chill employees in the exercise of their Section 7 rights." *Costco Wholesale Corp.*, Case 34–CA–012421, 358 NLRB No. 106, slip op. at 2 (Sept. 7, 2012).

By and large, EPL insurance policies do not cover violations of the NLRA, except for retaliation claims that may fall within a "retaliation carve-back," which carves back coverage for claims arising out of retaliatory treatment. Therefore, because of the limited coverage available for NLRB claims, when companies develop social media policies to address reputational and cyber-bullying related risks, they should be careful to avoid creating a social media policy that inadvertently creates potentially uncovered NLRA exposure.

Advertising Injury Coverage for Claims Arising Out of Social Media Advertising and Marketing

Another new exposure arising out of social media relates to online advertising and marketing. As advertising and marketing campaigns move away from traditional websites controlled by a company and toward social media where companies do not control the messaging, more and more companies allow—and even expect—their employees to be a part of their online advertising platforms. In fact, many companies allow third-party users, unassociated with the company, to play a role in their marketing and advertising. The dark side of this trend is that although companies may have no control over who comments on their social media, they may be found vicariously liable for defamatory posts on interactive websites, Facebook pages, and Twitter feeds.

Companies do have some protection against defamatory third party posts, even on their own platforms under the Communications Decency Act ("CDA") of 1996, which grants providers and users of "interactive computer service[s]" legal immunity from liability. 47 USC § 230(c)(1). That means that an owner of a website or a creator of a Facebook page cannot be held liable for defamatory comments published on its site. However, if the interactive computer service provider or user becomes an "information content provider" by editing a post in issue or responding to it in a defamatory manner, then legal immunity under the CDA ceases.

Moreover, even if a company has a strong social media policy in place, well-intentioned employees who respond to disparaging comments about the company for whom they work may inadvertently create liability for their employer when they respond to third party posts. For instance, employers may be found vicariously liable for employees' defamatory comments on social media against other companies or competitors. While there is little case law concerning this issue, under the common law doctrine of vicarious liability, an employer is generally liable for an employee's defamation if it was done within the scope of employment, a risk which may be heightened when employers encourage their employees to help implement social media marketing strategies.

Defamation-related risks traditionally have been covered under standard commercial general liability ("CGL") policies, which provide broad coverage for "personal and advertising injury," which includes coverage for, among other things, libel, slander, invasion of privacy, and certain types of trademark and copyright infringement risks. In response to the growing use of social media, however, insurers have increasingly limited the scope of coverage for advertising injury exposure arising out of the use of the internet and social media. For instance, insurers are increasingly attempting at renewals to insert an "electronic chat-room or bulletin board" exclusion, if not more broadly worded exclusions, to limit their liability for advertising injuries arising out of social media.

Similarly, while insurers have for many years attempted to limit their liability for invasion of privacy claims arising under the Telephone Consumer Protection Act of 1996 ("TCPA") and the CAN-SPAM Act of 2003, in response to the recent proliferation of state privacy protection statutes, insurers increasingly are using a broader, so-called "Violation of Statutes" exclusion in an attempt to eliminate any coverage under CGL policies for statutory privacy claims. To date, insurers attempting to enforce this type of exclusion have obtained mixed results, with some courts interpreting these types of exclusions broadly and other courts applying the exclusions more narrowly in keeping with pro-policyholder rules of insurance construction applicable in most jurisdictions. *Compare National Union Fire Insurance Company of Pittsburgh, PA v. Coinstar, Inc*., No. C13-1014-JCC, 2014 WL 868584 (W.D. Wash. Feb. 28, 2014) (holding that "Violation of Statutes" exclusion in CGL policies precluded coverage for allegations that the policyholder disclosed customers' personal information in violation of the Video Privacy Protection Act), *with Hartford Casualty Insurance Co. v. Corcino & Associates*, CV 13-03728-GAF, 2013 WL 5687527 (C.D. Cal. Oct. 7, 2013) (holding that a general liability policy covered data breach claims alleging violations of California patients' right to medical privacy when medical information of the underlying plaintiffs was posted on a public website, "Student of Fortune"—an online tutorial marketplace for students who need help with their homework—and rejecting insurers' attempted application of exclusion for liabilities resulting from a violation of rights created by state or federal acts). A company's use of social media increases the opportunity—and, therefore, the danger—that the company or its employees will post information on a social media forum that implicates a federal or state privacy statute, and therefore insurers may argue that a "Violation of Statutes" exclusion bars insurance coverage for any liability under such statute. Healthcare and financial professionals must be particularly careful, since consumers in both of those fields are protected by privacy statutes. *See, e.g.*, Gramm-Leach-Bliley Financial Modernization Act of 1999; Health Insurance Portability and Accountability Act of 1996 ("HIPAA").

In tandem with the emergence of new exclusions, insurers are increasingly offering stand-alone insurance coverage to address advertising injury exposures arising out of the use of social media. Indeed, policyholders in media and internet related businesses generally must buy stand-alone media liability policies to obtain any coverage for advertising injury exposure, and insurers are increasingly offering insurance products specifically tailored to cover social-media based liabilities, such as defamation claims arising out of an employee's social media use at work. While the new insurance products may address a need in the marketplace for this type of coverage, these new products, when coupled with broader exclusions to CGL advertising injury coverage, create the potential for coverage gaps.

Tips For Reducing Social Media Exposure

- Because insurance coverage for social media exposure is often uncertain, but staying off social media is not an option, every company should craft a social media policy to reduce the risk of claims arising out of the use of social media at work. These policies should be tested and regularly audited and updated as new social media outlets continually emerge.

- While social media policies are often drafted in silos by marketing, IT, or human resources departments, the best approach is to form a team consisting of human resources professionals, IT professionals, marketing departments, in-house counsel, and corporate risk managers to ensure that an appropriate balance is struck between the important goal of engaging with potential and existing customers via social media and the need to protect the company against social media exposures.

- Companies should develop a social media crisis management plan to avoid miscues when responding to social media trends that may threaten the company's reputation, and train the employees principally responsible for social media marketing to protect the company's brand and to minimize the company's exposure in the event of a social media crisis.

- Because newer social media insurance coverage products and emerging social media exclusions in CGL, EPL, and E&O policies are largely untested in the courts, any company with social media exposure should carefully review its existing coverage at renewal with its broker and outside counsel, and beware of new endorsements containing hidden social media exclusions that may limit coverage.

We work closely with our clients and their risk managers to ensure their insurance affords adequate protection in the event of advertising injury claims. We also have helped many businesses develop social media policies and collect from their insurers for losses arising from the use of electronic media.

* * *

KING & SPALDING

Client Alert

Antitrust Practice Group

August 25, 2014

DOJ Fines Berkshire Hathaway $896,000 for Failure to Comply with Premerger Notification Requirements

On August 20, 2014, Berkshire Hathaway Inc. ("Berkshire Hathaway") settled with the Department of Justice, Antitrust Division (DOJ) and the Federal Trade Commission (FTC) for its failure to comply with the premerger notification requirements and waiting requirements in the Hart-Scott-Rodino ("HSR") Act of 1976 ("the Act"). As part of the settlement, Berkshire Hathaway agreed to pay $896,000 for failing to report the conversion of notes it owned in building products company USG Corp. ("USG") into voting securities in December 2013. As a result of the transaction, Berkshire Hathaway's voting securities in USG were valued at more than $950 million, well above the $283.6 million HSR reporting threshold in effect at the time of the conversion. The swap was therefore subject to the HSR Act's reporting requirements. According to DOJ's complaint, this marks the second time in the past two years that Berkshire Hathaway failed to comply with the premerger notification requirements when acquiring voting securities.

The HSR Act requires reporting of non-exempt acquisitions of voting securities or assets that meet certain value thresholds. Failure to comply with the Act's requirements can result in a maximum civil penalty of $16,000 for each day of the ongoing violation.

According to the Complaint, Berkshire Hathaway owned approximately 19% of outstanding voting securities of USG in 2006. In 2008 it then purchased contingent convertible notes in USG in aggregate principal amount of $300 million. When USG sought to redeem the notes in November 2013, Berkshire Hathaway converted its notes into voting securities, resulting in an approximate 28% ownership of USG voting securities valued at more than $950 million. Berkshire Hathaway eventually corrected its mistake and filed HSR on January 3, 2014, resulting in a continuous violation of the Act until the February 3, 2014 expiration of the waiting period.

This was not the first time Berkshire Hathaway did not comply with the HSR premerger notification and waiting requirements. On June 25, 2013, Berkshire Hathaway failed to notify its acquisition of voting securities of financial services company Symetra, resulting in ownership exceeding the HSR reporting threshold. In that case, Berkshire Hathaway made a

For more information, contact:

Jeffrey S. Spigel
+1 202 626 2626
jspigel@kslaw.com

Peter M. Todaro
+1 202 626 5518
ptodaro@kslaw.com

Brian R. Meiners
+1 202 626 2910
bmeiners@kslaw.com

John D. Carroll
+1 202 626 2993
jdcarroll@kslaw.com

King & Spalding
Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

corrective HSR filing on July 2, 2013 and characterized its failure to comply with HSR rules as "inadvertent." In response, the Federal Trade Commission's Premerger Notification Office sent a letter to Berkshire Hathaway indicating that it was not going to recommend a civil penalty, but required Berkshire Hathaway to "institut[e] an effective program to ensure full compliance with the Act's requirements."

This Complaint and settlement highlight the need for any company contemplating a transaction to seek legal advice to determine if the transaction triggers an HSR filing obligation; even relatively small transactions can be subject to HSR reporting requirements. The FTC and DOJ pay close attention to transactions—reported and not—and will take swift action to investigate and litigate violations of the federal antitrust laws and HSR Act. When a company does not take steps to ensure antitrust compliance, it could result in costly fees and negative publicity, even for inadvertent failures to report.

Documents

The DOJ press release (August 20, 2014) is available at http://www.justice.gov/opa/pr/2014/August/14-at-880.html.
The DOJ complaint (August 20, 2014) is available at http://www.justice.gov/atr/cases/f308100/308150.pdf.

* * *

KING & SPALDING

King & Spalding Antitrust Cartel Practice Continues to Receive National Recognition

Chambers USA has again recognized King & Spalding as having a leading antitrust practice in its 2014 guide to the leading legal practices in the United States.

Chambers USA selected King & Spalding for inclusion in the highly prestigious "Band 1" of nationwide antitrust cartel practices, the highest ranking available. *Chambers USA* noted that King & Spalding's antitrust group has a "strong heritage of criminal cartel-related work and a roster of attorneys experienced in that field" and that the group is "often seen in some of the major ongoing government investigations." Clients told *Chambers USA* that the firm's lawyers "were very responsive, thorough and accurate" and that "King & Spalding has performed exceptionally well."

Chambers USA recognized a number of King & Spalding antitrust lawyers: Jim Griffin, a former Deputy Assistant Attorney General for Criminal Enforcement in the U.S. Department of Justice's Antitrust Division, described as "an experienced and highly regarded antitrust cartel specialist…[with] an extensive background in private practice and at the DOJ;" Grace Rodriguez, a "great lawyer…who undertakes a range of litigation matters, including government investigations and cartel work;" and Jeff Cashdan, who is described as "'excellent'…with sources commenting on his knowledge of the practice area [and who] recently represented InterContinental Hotels Group in the online travel company hotel booking litigation."

In addition, two other King & Spalding antitrust lawyers have recently received recognition in the field. Wendy Waszmer joined King & Spalding in 2013, after serving as the Assistant Chief of the New York Field Office and Counsel to the Assistant Attorney General of the U.S. Department of Justice Antitrust Division, and has spoken at several recent events regarding U.S. and international cartel enforcement, including the American Bar Association Antitrust Section's Spring Meeting. Alan Dial recently was named a vice chair of the ABA Antitrust Section's cartel and criminal practice committee.

We are honored to have received these recognitions, particularly those based on the feedback of our clients, whom we look forward to continuing to serve.

Our Antitrust Practice

King & Spalding's antitrust cartel lawyers have been involved in virtually all the significant cartel cases over the past decade, including most of the major criminal cartel cases brought by the U.S. Department of Justice and many of the cartel Statement of Objection/Oral Hearing proceedings before the European Commission. Our team includes lawyers with substantial government prosecutorial experience, including a former Assistant Attorney General in charge of the U.S. Department of Justice's Criminal Division and a former acting Deputy Attorney General of the U.S. Department of Justice, as well as former United States Attorneys and leaders of the Antitrust Division. In addition, our antitrust lawyers provide sophisticated, solution-oriented advice on all aspects of competition law, including mergers and acquisitions, joint ventures and other strategic alliances, government civil and criminal investigations, private antitrust litigation, and counseling.