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SEC Alleges GC, Public Corporation Committed Securities Fraud by Failing to Disclose a Potential DOJ Settlement

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Late last year, in an unprecedented course of action, the Securities and Exchange Commission (the ''SEC'') filed a complaint against RPM International Inc. (''RPM'') and its general counsel, Edward Moore, which should give general counsel and publicly-traded companies cause for concern. Specifically, the SEC alleged that RPM and its general counsel violated federal securities laws by failing to accrue for and to disclose the value of a *potential* settlement with the Department of Justice (''DOJ'') relating to a sealed *qui tam* complaint at the center of an *ongoing* DOJ investigation. The complaint alleges a parade of internal disclosure horribles. At its core, however, the complaint makes questionable assumptions regarding the precision with which publicly-traded companies and officers responsible for making such disclosures under the federal securities laws can—and, indeed, *should*—disclose their anticipated posture in ongoing government investigations and litigation.

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SEC's Complaint and Theory

The SEC's lawsuit stems from the $60.9 million settlement between Tremco, Inc. (''Tremco''), RPM's wholly-owned subsidiary, and the SEC relating to allegations, initially raised by a whistleblower, that Tremco had violated the False Claims Act (the ''FCA''). According to the SEC complaint, a former Tremco employee filed a *qui tam* lawsuit in July 2010 under the FCA alleging that Tremco failed to provide required price discounts in a government contract. As with all *qui tam* lawsuits filed under 31 U.S.C. § 3730(b), the whistleblower filed the complaint under seal while the government investigated the whistleblower's claims and de-

cided whether to intervene. This serves the important policy goals of protecting both the whistleblower and the corporation.

The SEC alleges that RPM learned of the whistleblower suit in March 2011, when it served a subpoena on RPM for documents relevant to its investigation, and that Moore, RPM's general counsel and chief compliance officer, oversaw both companies' responses to DOJ's investigation. The company first saw a *partially unsealed* whistleblower complaint in August 2012, per the SEC. According to the SEC, in September 2012, RPM's outside counsel estimated that Tremco overcharged the government by at least $11 million during a limited time within the broader investigation period. In October 2012, Moore allegedly represented to management that neither he nor outside counsel believed that a material loss contingency exceeding $1.2 million existed.

Here, the SEC's theory is that Moore and RPM knew or should have known that the FCA allows the government to seek damages that are multiples of the amount overcharged and as a result knew or should have known that RPM's fine was going to be substantially larger. The company, in turn, should have accrued for this material loss contingency and disclosed it to shareholders, according to the SEC.

The SEC's complaint alleges that Moore made a series of questionable decisions with respect to internal disclosures to the company's management, its Audit Committee, and its external auditors. The complaint suggests that Moore never showed the Audit Committee the partially unsealed FCA complaint. It further alleges that in September 2012, Moore told an external auditor that ''no claim has been asserted'' in the FCA whistleblower suit and characterized the matter as ''investigative in nature and not in litigation.'' The following month, Moore allegedly failed to tell the Audit Committee of the $11 million estimate of RPM's liability in the *qui tam* suit.

During a December 2012 conference call, Moore, RPM's outside counsel, and other RPM personnel allegedly discussed revised estimates of a potential DOJ settlement. The SEC alleges that the estimate—$27-$28 million—did not take into account the FCA's multiplier damages. Again, Moore allegedly failed to disclose the estimates to RPM's officers and board members. None of these estimates appeared in RPM's SEC filings, which, the SEC alleges, violated GAAP provisions of which Moore and the company should have been aware.

Notably, according to the complaint, RPM made its first settlement offer to the DOJ on January 11, 2013, and on March 2013, the DOJ countered. RPM recorded an accrual for its liability relating to the DOJ investigation on April 1, 2013, and disclosed the accrual in the first quarterly statement since the company's initial offer, on April 4, 2013. In other words, the company accrued for and disclosed the material loss contingency in the first quarterly statement after the company and the DOJ swapped settlement proposals.

This Litigation Can Have Serious Consequences for Public Companies

Setting aside the questionable decisions that Moore allegedly made regarding internal disclosures, the SEC's complaint raises serious concerns for officers and directors of publicly-traded companies. The SEC largely ignores the fact that settlement negotiations with DOJ and other regulators can be a lengthy, complicated process in which a variety of different factors may shape the outcome. In many instances, a settlement requires some amount of rough justice, which prevents the company from determining its potential liability in advance with any reasonable certainty. DOJ, for example, will consider, among other things, the company's ability to pay a significant fine, the collateral consequences of a significant fine, and whether the company's cooperation or civil and regulatory remedies militate in favor of reducing the company's criminal liability. And where DOJ has discretion to multiply damages, as is the case with the FCA, DOJ can decide not to use that authority. All of these factors make determining the probability that a fine will be assessed and estimating reasonably a potential fine difficult and largely speculative. Nevertheless, in the SEC's lawsuit against RPM and Moore, the SEC requests that the court engage in an anachronistic analysis—because the settlement between the DOJ and RPM *was* $60.9 million, the company *should have known* it was going to be as high in the early stages of the investigation.

The SEC's theory also runs counter to the public policy of encouraging settlements. If the SEC prevails, it may create a situation where public companies are required, or feel compelled, to disclose publicly their preliminary valuations of ongoing government investigations and litigation, even if the corporation has not yet made a settlement offer and the potential liability could not be reasonably estimated given the various factors. That outcome is undoubtedly problematic. Public companies are consistently exposed to various types of investigations and litigation. If they are forced to disclose how they value those disputes, especially before they have made an offer to the other side to resolve them, it would render them toothless in their ability to resolve disputes.

While the court here evaluates the disclosure obligations of public companies and their general counsel, companies and general counsel can take steps to avoid being in the crosshairs of the SEC. Public companies subject to a government investigation and their general counsel should be cognizant that the SEC may take the position that companies should accrue for a potential liability and disclose it as soon as possible, even if the government's investigation is at a preliminary stage. This is problematic and may be unrealistic for the reasons discussed previously. Additionally, general counsel should work closely with management, the company's auditors, and its outside counsel to ensure that all interested parties are aware of the relevant facts and the status of the investigations.

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