COMPANIES

Securities Disputes Raise Procedural Dilemmas

UNDER SIEGE:

and Related Issues

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THE CHALLENGE

Securities-fraud lawsuits and governmental investigations are not new. In fact, whenever public companies have decided to disclose what could be considered unwelcome news, they have always kept a wary eye open for class-action plaintiffs' lawyers and various governmental bodies. However, today more than ever before, companies seem to be besieged by a battery of securities-fraud lawsuits, derivative lawsuits, ERISA claims, and governmental investigations where, in the past, they might have faced only a securities-fraud lawsuit and/or an investigation. The pendency of these types of claims and investigations, with different but related issues, varying standards of proof, and disparate civil and possibly criminal remedies, presents counsel with critical issues and judgment calls at each stage, particularly at the outset. In this article, we identify some of these issues and examine the practical considerations that go into addressing them.

INITIAL REPRESENTATION AND INVESTIGATORY ISSUES

Representational Issues. It is natural for a company facing a battery of claims in different forums to reach out to one law firm to represent it, as well as some or all of its current and former directors and officers. This approach is clearly defensible, since the various lawsuits and investigations traditionally involve a common nucleus of facts and issues. However, the ability of a company to retain one law firm to protect it may be compromised by various conflict and other representational issues. Without question, a great deal of thought and analysis must, at the outset, go into understanding the issues that exist and determining which firms may be available to represent particular defendants and targets.

Three primary considerations are at play here. First, legal conflicts may prevent a single law firm from representing a company as well as its officers and directors. By way of example, while it may be totally appropriate for a single law firm to represent the company and its executives as defendants in a securities-fraud lawsuit, that same firm may not be able to represent the company and its executives simultaneously through trial in the related derivative action. After all, a derivative action in this context is, by definition, a claim brought *on behalf of* the company *against* certain of the officers and directors.

Second, in this day and age, it is important for companies to recognize that different types of claims require different, often highly targeted legal skills. Securities litigators are often tapped to handle securities fraud and even shareholder derivative lawsuits. However, those lawyers may or may not have the requisite experience to handle a civil or criminal investigation, normally the mainstay of lawyers with prosecutorial or SEC experience. Furthermore, many companies are now facing lawsuits alleging that they, along with certain officers and directors, violated fiduciary and other obligations under ERISA. Those kinds of allegations require highly experienced lawyers with an understanding of the ERISA laws and the fiduciary obligations imposed upon those who manage and/or oversee a company's employee benefit plans.

Third, while it is very common for current and former officers and directors to be sued along with the company, and for each of them to believe and want to argue that their conduct and that of the company was aboveboard, individual defendants, particularly if they no longer are employed at the company, may have vastly different concerns and expectations as to timing, extent of involvement, willingness to incur risks, and feasible outcome. In this vein, it is important to acknowledge that former officers and directors who may have devoted years of loyal service to the company may now value a quick resolution, no matter the cost to the company, over what may otherwise be in the interests of the company. The bottom line is that former officers and directors and, sometimes, current officers and directors may require separate counsel.

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Board Investigations. Management and the directors of a company may have a duty to investigate the facts that gave rise to litigation, or they may simply want to do so. At times, a company may be able to halt derivative litigation by forming a special committee to investigate allegations asserted in a derivative lawsuit. Beyond this, many companies have internal audit departments that either have been monitoring the issues giving rise to litigation or will want to do so. Those departments usually view it as part of their regular obligations to initiate investigations following the assertion of claims.

The discharge by the board and/or management of their respective duties to investigate is crucial, but it must be weighed against the need to protect the company in litigation. This involves numerous considerations. Investigations may be required by the proper discharge of the board's duties or management's. Thus, the failure to investigate may itself be actionable. But on the other hand, the initiation of an investigation must be tempered by the realities. While an early investigation may take advantage of the fact that the events are fresh and related documents are readily available, the record may be incomplete, or if complete, not totally understood. And while the desire to move quickly is human

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nature, a "rush to judgment" must be avoided at all costs. This is especially the case where lawsuits or governmental investigations have been commenced, since an internal investigation may well provide a discoverable road map to actual or prospective plaintiffs or investigators.

In-house legal investigations or reviews may not be immune from these concerns. While such investigations may well be privileged, such privileges are waivable, especially when the results have been provided to auditors, outside investigators, or even governmental investigators on a selective basis. Certainly, no in-house law department relishes the prospect of its own investigations being used against the company's interests.

DEFENDING THE COMPANY/CLAIMS ADMINISTRATION AND DEFENSE

Coordination of the various actions and/or investigations will prove to be a substantial—and very important—task that the company and its counsel must undertake. It is one of the issues that will need to remain in the forefront of the strategic thinking process throughout the course of the matters. The company and its counsel will need to treat the various actions and investigations as pieces of a single coordinated defense effort because of the impact that a misstep or shortsighted decision in one matter may have on the overall defense.

Accordingly, just as developing a case theme early in the defense of an action is important to shape the defense efforts, development of a consistent story across various actions is essential to the successful management of the slate of actions. This is particularly true because of the often public nature of these actions, the possibility that multiple actions may be before a single court or federal district, and the potential for information sharing among plaintiffs and/or governmental investigatory agencies. Failing to present a consistent defense among the various matters risks loss of credibility before the court(s) and the creation of evidentiary and/or briefing fodder for the various plaintiffs.

Consolidation and Coordination of Claims and Actions. While it will rarely be possible to formally consolidate all claims against the company and its officers and directors in one forum, much can be accomplished if desired. The most basic step would be a consolidation of similar actions pending before the same state or federal court. Similarly, related federal actions—securities, ERISA, and/or shareholder derivative actions—may be consolidated through multidistrict litigation ("MDL") proceedings. Once MDL treatment is secured, informal coordination of state-court cases under the MDL "banner" may also be possible. Formal coordination may not be feasible among governmental investigations or between civil litigation and governmental investigations. That said, in certain instances, a court or investigatory agency may give deference to or receive input from the other (*e.g.*, through *amicus curiae* submissions, etc.).

One issue to be considered is whether global or large-scale consolidation is necessarily the best course given the circumstances and dynamics at issue in a specific situation. Although consolidation may present numerous perceived benefits to the defense, it will also serve to decrease plaintiffs' costs and may enhance the pressure imposed by the court to settle early (which may or may not be perceived by the defendants as a negative factor).

Almost certainly, the employment of a joint defense arrangement among some or all defendants—whether formal or

continued on page 52

continued from page 13

informal—will be beneficial. Just as consolidation runs the risk of allowing coordination among plaintiffs' counsel, a joint defense arrangement will permit parties to share the defense load, including, as to briefing, fact development, discovery, and trial preparation.

Discovery. The discovery process—in the context of litigation or governmental investigations—presents dangers in any litigation, heightening the necessity for careful preparation. Broad-based, simultaneous discovery, often found in the current era of securities disputes, presents great opportunities but significant challenges. The opportunities and challenges only increase where related matters have been initiated.

Document Productions. Defendants should consider whether to keep document productions separate for each matter. Even if productions are separated, to the extent possible (this will obviously be driven by the document requests), the goal should be to produce the same documents, using the same document-management system, to each claimant.

A similar consideration is whether to resist document- and deposition-sharing arrangements among plaintiffs' counsel in each matter. The cost of reproducing documents or producing witnesses a second time may be less than the value claimants may derive from a cooperative effort. Another consideration is whether defendants will realistically be able to prevent sharing among counsel or producing the materials to all of the counsel. Defendants should normally seek to avoid putting themselves and their witnesses in the position where a single deponent will face multiple depositions by plaintiffs' counsel who are progressively more educated. Providing plaintiffs with multiple "bites at the apple" in this manner presents a significant risk.

Privilege. Privilege decisions take on added importance in the situation where privileged materials could be harmful on numerous case fronts. The most damaging documents may be cloaked in a proper privilege; defense counsel should ordinarily be diligent in protecting any privilege and avoid waiver of the privilege. Governmental investigatory bodies (*e.g.*, the SEC) may be quite persuasive in attempting to secure a voluntary production of privileged documents. Although there is support (including recent authority) for the notion of a limited waiver of privilege in certain circumstances, counsel must approach waiver decisions with the expectation that a disclosure of privileged material to the government may be argued to effectively result in a total waiver.

Disclosure to auditors and other investigators of privileged documents, especially if used in a published report, may similarly be argued to constitute a waiver as to claimants. This issue may take on added significance in situations where potential accounting irregularities are in question and auditors threaten to hold an audit report until privileged or work-product protected materials are produced and analyzed. Care and planning must also be given to communicating with insurers regarding the status and risks of defense without waiving applicable privileges.

Settlement Considerations. Proceeding with numerous related actions also implicates a number of settlement considerations. While a global settlement is always desirable, it may not always be possible.

First, the various matters may not all be in a procedural posture that facilitates a coordinated settlement. For example, to the extent that derivative actions have been stayed during the pendency of a securities action, it may be more difficult to reach a settlement of those actions quickly should a settlement of the underlying securities action be brokered. Insurers may object to or refuse to tender policy proceeds toward a settlement that does not resolve all of the claims that have been noticed against the policies.

Second, the existence of insurance policies that are expected to contribute to any settlement creates an additional complication from the perspective of seeking a global settlement (or keeping open the possibility of seeking such a settlement). Depending on how the company's insurance tower is structured, there may be multiple towers implicated by the various matters. For example, an ERISA action may fall

within one tower, while securities/derivative actions may trigger another tower. Additionally, within a tower that applies to securities and shareholder derivative actions, certain layers may respond to both types of actions, while upper layers may limit coverage (so-called "Side A only" insurance, which might respond to derivative but generally not securities claims).

Third, both class and derivative litigation settlements generally require court approval. Counsel should consider whether presenting a global settlement of the various related actions may make it easier to obtain approval. For example, a court may be more inclined to approve a shareholder derivative settlement if the settlement is part of a global settlement in which related claims against the company are resolved and the company's shareholders receive a significant benefit.

Finally, the timing of a civil litigation settlement may be influenced by the existence of governmental investigations. Because an investigation may be the first to reach final conclusion on the merits, counsel should consider the impact of a potentially adverse agency determination or action on the settlement (and/or trial) dynamics in the civil actions. To the extent that an adverse determination would have a significant impact on the civil actions, seeking a settlement sooner rather than later may be in the defendants' best interests. ■

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