CHAPTER 11

DEFENDING COMPANIES IN CRISIS

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SYNOPSIS

§ 11.01 Introduction

Any number of events can place a corporation in crisis. The disclosure of substantial trading losses, the failure of a critical product followed by a massive recall, the discovery of significant accounting discrepancies, or an environmental disaster are just a few examples. But companies in crisis, whatever the cause, face a common predicament: the corporation embroiled in a crisis must respond almost instantaneously to regulators, the public, the press, and Congress, having had limited opportunity to develop and understand the facts. These responses, given in the critical and typically fraught early stages of the crisis, can have a significant and potentially very negative impact—not only on the corporation's relationship with these constituencies, but also on the defense of the inevitable follow-on securities class-action lawsuit. For example, as discussed in more detail below, the company in crisis may find that it has no choice but to disclose information to regulators or Congress in a way

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that will cause it to lose the benefit of the automatic stay of discovery that typically applies after the filing of a motion to dismiss a class-action complaint. More generally, a company responding to the demands of a critical public or Congress may have no choice but to employ a far more cooperative or open strategy than is typical for a defendant in a litigation involving massive financial exposure from a class-action lawsuit.

No corporate crisis exactly mirrors another. Yet, the special challenges and considerations that come with defending a company in crisis are often the same: developing the facts rapidly in order to respond to regulators; preparing the company's public statements; and responding to Congressional requests for information and testimony. None of these familiar tasks for a company in crisis are likely to warm the heart of counsel defending against a securities class-action lawsuit. And all of these tasks may provide succor to class-action plaintiffs, who will be drafting a consolidated complaint or perhaps first moving to lift the automatic stay of discovery in order to obtain presentations and other documents provided by the company in crisis to regulators.

Because there is no blueprint for successfully managing a corporate crisis without damaging the defense of a corporation in the securities class-action lawsuit, below we seek to highlight some unique challenges and common pitfalls. We suggest strategies to address the particular challenges, but, in the end, ensuring the company's survival will always trump preserving the best possible defense of the company in the class action. And that is how it must be.

§ 11.02 Developing the Facts Quickly

In a crisis situation, a company has an immediate need to master the facts so that it can communicate quickly and accurately with its stakeholders, the public, Congress, and regulators. But how? Who runs the investigation—defense counsel for the company in the securities class-action or counsel for the audit committee or the Board? How can privilege be maintained if the results of the investigation are communicated to regulators? How can the facts be uncovered and presented to the regulators (and perhaps Congress and the public) without providing a road map to the class-action plaintiffs who will use any disclosures to prepare their class-action complaint?[1]

For all of these issues, there is no one right answer. A company in crisis simply cannot afford to remain ignorant of the relevant underlying facts because there will be a pressing need to communicate with regulators and the public. Without an appreciation of the core facts, a company will not be able to ensure that its statements to the regulators and the public are accurate, risking that at some later time either

[1] For more on internal investigations, see DEFENDING CORPORATIONS AND INDIVIDUALS IN GOVERNMENT INVESTIGATIONS, ch. 4 (Daniel J. Fetterman & Mark P. Goodman eds., 2011); David M. Brodsy, et al., *Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations*, 46 AM. CRIM. L. REV. 73 (2009); Thaddeus J. Malik, David M. Greenwald & Mercedes M. Davis, Special Committees and Protecting Privilege, The Corporate Counselor, Vol. 22, No. 10, Mar. 2008.

constituency may question the credibility of the company. The company may also not be able to take advantage of an early opportunity to settle with regulators or with litigants and perhaps ensure the company's survival. And the legitimacy of any disclosures or reports made by the company about the underlying facts may depend on the perceived and actual independence of the entity preparing the report. In virtually any scenario, defense counsel is likely to find itself in the uncomfortable situation of early and public disclosure of the underlying facts, sometimes even before the complaint or motion to dismiss has been filed.[2] All of this, of course, greatly complicates the defense of the class action, but may not be avoidable in a crisis where corporate survival trumps the defense of the class-action litigation.

But decisions that help in the ultimate defense of the class action action can still be made through this process. If an internal investigation has been conducted and the results are to be communicated to regulators, what form will the communication take?[3] It should almost always be assumed that, if a written report on an internal investigation is presented to a regulator, it will eventually fall into the hands of the securities class-action plaintiff, who can argue that the company has waived privilege.[4] Even an oral presentation may constitute waiver.[5] Accordingly, the company may attempt to limit the type of information that is included in its presentation. Guidance from the U.S. Department of Justice ("DOJ") differentiates between what it calls "core" attorney-client communications and work product, which the DOJ cannot request the company to disclose, from the underlying facts that are uncovered by attorneys during an internal investigation, which it can request the company to disclose.[6] The U.S.

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[2] Indeed, these communications may not be protected by the traditional work product doctrine should litigation eventually commence because a court could determine that such internal investigations are done for business purposes, rather than in anticipation of litigation, and thus are not entitled to the protection. *See In re* Kidder Peabody Sec. Litig., 168 F.R.D. 459, 466 (S.D.N.Y. 1996) (finding that work-product protection did not apply to investigation because a "detailed and painstaking inquiry was required for pressing business purposes and thus would have been undertaken regardless of whether litigation was threatened").

[3] But note that an oral presentation can also result in waiver of privilege as to third parties. *See* United States v. Reyes, 239 F.R.D. 591, 604 (N.D. Cal. 2006) (finding law firms' argument that privilege was maintained because no written materials were shared with DOJ and SEC, only oral communications, "specious"). For additional commentary on internal investigations and privilege, see Mary Beth Hogan & Philip Fortino, *The Attorney-Client Privilege and Internal Investigations: Privilege Issues in Structuring an Investigation and Interviewing Witnesses*, 154 PLI/NY 193 (Dec. 19 & 21, 2005) and Brodsky et al., *supra* n.1.

[4] See infra § 11.04 (discussing waiver of privilege).

[5] *See* United States v. Reyes, 239 F.R.D. 591, 604 (N.D. Cal. 2006) (finding law firms' argument that privilege was maintained because no written materials were shared with DOJ and SEC, only oral communications, "specious" because "the transmission of privileged information is what matters, not the medium through which it is conveyed"). For additional commentary on internal investigations and privilege, see Mary Beth Hogan & Philip Fortino, *The Attorney-Client Privilege and Internal Investigations: Privilege Issues in Structuring an Investigation and Interviewing Witnesses*, 154 PLI/NY 193 (Dec. 19 & 21, 2005) and Brodsky et al., *supra* n.1.

[6] *See* U.S. Dep't of Justice, United States Attorneys' Manual § 9-28.710 *Principles of Federal Prosecution of Business Organizations* (2012) (hereinafter "*DOJ Corporate Charging Guidelines*")

Attorneys' Manual's Principles of Federal Prosecution of Business Organizations (hereinafter, "DOJ Corporate Charging Guidelines")—the guidelines that federal prosecutors must follow when contemplating charging a corporation—references by way of example that interview memoranda and notes prepared by counsel may be privileged, and the DOJ may not request those notes, but that the company must disclose the underlying facts recorded in those memoranda and notes if it wants to obtain cooperation credit.[7] In presenting any such underlying facts, counsel should be cautious when quoting or paraphrasing underlying documents and interview notes, which can effect a waiver for the underlying documents.[8]

The initial consideration frequently is whether the company should conduct a formal investigation run by an independent board committee with new counsel unconnected to the company. Too often, the company in crisis perceives its choice as between conducting an independent investigation or none at all. This need not be the case. In many instances, the company should first turn to traditional counsel (whether internal or external) to conduct a quick review of the relevant facts, provided that counsel is not conflicted because of their personal involvement in the conduct giving rise to the crisis. The company can then determine whether a need exists, or time permits, to conduct a full-scale formal investigation by an audit or special committee of the board using independent counsel. When a company is in crisis and there is no time to waste in getting a handle on the key facts, there is nothing wrong with long-time counsel, who understands the business and may have relationships with key officers, conducting a quick, preliminary review of the documents as well as targeted interviews of the company's important players. In conducting those interviews, counsel must, of course, be careful to clearly warn corporate officers who are interviewed that counsel represents the company and not the individuals, and that the company will decide whether to keep any information provided confidential.[9] The failure to provide these warnings can have severe repercussions.[10] Company counsel should also address early

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available at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm. The SEC guidance is in accord. United States Securities and Exchange Commission, Division of Enforcement, Enforcement Manual, § 4.3 (Mar. 9, 2012) (hereinafter "*SEC Enforcement Manual*"), *available at* http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[7] *DOJ Corporate Charging Guidelines* § 9-28.720 n.3. Likewise, communications, usually preceding an internal investigation, regarding the "legal implications of the putative misconduct at issue" are "core" attorney-client communications and work-product and the DOJ may not request them. *Id.* § 9-28.720.

[8] *See, e.g.*, SEC v. Vitesse Semiconductor Corp., 10 Civ. 9239 (JSR), 2011 U.S. Dist. LEXIS 77538 (S.D.N.Y. July 13, 2011) (finding waiver of work-product protection because law firm conveyed substance of handwritten notes through "very detailed oral summaries" to SEC).

[9] *See, e.g.*, Model Rules of Prof'l Conduct, R. 1.13(f) ("In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing."); Upjohn Co. v. United States, 449 U.S. 383 (1981).

[10] For example, a federal district judge strongly criticized attorneys at a California law firm for breaching their duty of loyalty to a client, the chief financial officer ("CFO") of a company, when they interviewed him concerning the backdating of stock options without making clear that they were acting

on the vexing question of whether to offer to provide an employee with personal counsel at the company's expense since doing so will likely slow down the process significantly.

Finally, in undertaking a quick assessment of the facts or even a formal investigation, company counsel should consider the implications of hiring outside experts, such as forensic accountants or financial experts, to assist in gathering and interpreting the facts. In particular, counsel should focus on the mechanics of the retention to provide the best argument down the road for the preservation of privilege and work-product protections with respect to the work of experts who are assisting in the initial fact-gathering effort. Almost always, privilege and work-product concerns should lead counsel to retain the experts so that their reports are more likely to be protected as work product.[11] We address the related problems of using a public relations professional in Section 11.07.

§ 11.03 Considerations Regarding Representation

[1] Joint or Separate Representation? To Cooperate or Not to Cooperate with Individual Defendants

Typically, in setting up representations for the company and for the individual defendants in response to the filing of a securities class-action lawsuit, defense counsel will strive to keep defendants together and have everyone represented by the same counsel who appears for the corporation. By having one counsel, the court will receive one motion to dismiss, and defendants avoid the specter of multiple motions with possibly conflicting arguments. For a plain-vanilla securities class-action case this is often possible. When the company is in a crisis and the subject of intense media

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on behalf of the company and not the individual and later revealed information learned in the interview to the company's accountants and to regulators. United States v. Nicholas, 606 F. Supp. 2d 1109, 1117–21 (C.D. Cal. 2009) (granting order suppressing evidence obtained by company lawyers from CFO during internal interview), *rev'd* sub nom. United States v. Ruehle, 583 F.3d 600 (9th Cir. 2009). Although the Ninth Circuit reversed the suppression order based on the district court's erroneous application of state evidence law, the Ninth Circuit did not disagree with respect to the ethical breaches resulting from the failure of counsel to warn the CFO that they represented the company and not the CFO.

[11] Although not dispositive, counsel's retention and direction of experts is often noted by courts in considering whether the experts' analysis is work product. *See, e.g.*, *In re* Cardinal Health, Inc., Sec. Litig., 2007 U.S. Dist. LEXIS 36000, at *19–*20 (S.D.N.Y. Jan. 26, 2007) (noting that accounting experts were retained by, directed by, and reported to outside counsel and so their analysis was "protected by the work product doctrine"). Counsel should be aware, however, that mere retention of experts by counsel, or indeed the fact that an investigation is conducted by attorneys, is not a guarantee of work-product protection, particularly when there is evidence suggesting that the disputed documents "would have been created in essentially similar form irrespective of litigation." *See* Allied Irish Banks v. Bank of Am., 240 F.R.D. 96, 106 (S.D.N.Y. 2007); OneBeacon Ins. Co. v. Forman Int'l, Ltd., 2006 U.S. Dist. LEXIS 90970, at *11 (S.D.N.Y. Dec. 13, 2006) ("Investigatory reports and materials are not protected by the attorney-client privilege or the work-product doctrine merely because they are provided to, or prepared by, counsel."). *But see* Gruss v. Zwirn, 276 F.R.D. 115, 127, 129 (S.D.N.Y. 2011) (distinguishing *Allied Irish Banks* as dealing "primarily with documents containing factual statements," and finding that the "essentially similar form" inquiry is "inappropriate[ ] when applied to the notes and summaries of interviews created by attorneys during their investigation").

scrutiny and regulatory action, it may not be.

Indeed, when the crisis has focused on the alleged wrongdoing of a current or former chief executive officer or management team, there may be a legitimate need for the company at the very outset of the litigation to distance itself and insist on separate representations for the company and the individual officers, present or former. Indeed, conflicts rules may require separate representation. And in a crisis atmosphere, the outside directors, if named in the action, will also likely demand separate counsel and may have already retained that counsel even before the onset of litigation.

Regardless of the need for multiple representations, it is the job of company counsel to establish a working relationship with all counsel and to institute, when possible, regular calls or meetings to discuss strategies for defending the class action and for sharing, when appropriate, information concerning ongoing regulatory and Congressional inquiries. Cooperation in the defense of the securities class action and in developing the motions to dismiss must be accomplished even when, as is often the case, there will be current or potential disputes between the company and former management whose conduct may have led the company into the crisis. Whether this cooperation takes place pursuant to a joint-defense or common-interest agreement is yet another early issue to be confronted and may also have consequences not only in the public eye but also in dealings with regulators. Regulators may be reticent to share information with the company if they understand that it will be provided to former officers who may now be "targets" of a government investigation. Likewise, joint-defense or common-interest agreements may hinder the ability of the company to cooperate with the regulators if it should choose to do so.[12] Again, as with many of the issues we address here, there is no *per se* right way to proceed. Rather, counsel must consult carefully with the corporate client and understand that decisions regarding representation and cooperation are greatly complicated by a crisis.

[2] Indemnification and Advancement of Legal Fees

State corporation statutes vary but universally authorize a corporation to indemnify directors and officers and to advance the cost of the legal defense for those individuals subject to the execution of an appropriate undertaking to repay the fees if it is ultimately determined that the defendant was not entitled to indemnification.[13] The

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[12] The *DOJ Corporate Charging Guidelines* state that "the mere participation by a corporation in a joint defense agreement does not render the corporation ineligible to receive cooperation credit, and prosecutors may not request that a corporation refrain from entering into such agreements. Of course, the corporation may wish to avoid putting itself in the position of being disabled, by virtue of a particular joint defense or similar agreement, from providing some relevant facts to the government and thereby limiting its ability to seek such cooperation credit . . . . Corporations may wish to address this situation by crafting or participating in joint defense agreements, to the extent they choose to enter them, that provide such flexibility as they deem appropriate." § 9-28.730.

[13] *See, e.g.*, 8 DEL. CODE § 145 (specifically authorizing indemnification of and advancement to directors, officers, employees and agents); CAL. CORP. CODE § 317 (same); N.Y. BUS. CORP. LAW §§ 721–726 (specifically authorizing indemnification of and advancement to directors and officers). For a complete discussion of indemnification and advancement under state law, see Stephen A. Radin, THE

corporate charters of large American corporations almost always provide for the indemnification of officers and directors and for the advancement of legal fees "to the fullest extent permitted by law."[14] Typically, at the outset of the securities class-action lawsuit, the corporation will execute with the individual defendants (current and/or former officers and directors) a standard form of undertaking which commits the corporation to advance the cost of the legal defense, subject to the individual defendant's promise to repay those costs if appropriate as a matter of law.

In a crisis, however, even the straightforward issue of advancement may create special challenges. These include inquiries from regulators, who may be attempting to pursue former directors or others in connection with the events leading to the corporate crisis.[15] They also include adverse publicity.

While the DOJ Corporate Charging Guidelines prohibit DOJ attorneys from considering "whether a corporation is advancing or reimbursing attorneys' fees or providing counsel to employees, officers, or directors under investigation or indictment" in determining whether to charge the corporation with a crime, they nevertheless allow DOJ attorneys to inquire into indemnification and advancement agreements "where otherwise appropriate under the law."[16] Accordingly, DOJ attorneys may inquire into such arrangements in connection with assessing conflicts or in connection with an investigation into whether fees are being advanced in an effort to obstruct justice (where, for example, the advancement of fees is predicated on the recipient lying to the government). Further, the SEC and other regulatory bodies may still consider indemnification and advancement in determining the cooperation credit that is due to a company.[17]

BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 5169–5593 (2009); *see also*United States v. Stein, 435 F. Supp. 2d 330, 355–56 (S.D.N.Y. 2006) (noting that accounting partnership KPMG had an "unbroken track record of paying the legal expenses of its partners and employees incurred as a result of their jobs, without regard to cost" and finding the prosecutors' pressure of KPMG to refuse indemnification a violation of the employees' Fifth Amendment rights), *aff'd*, 541 F.3d 130 (2d Cir. 2008). The District Court's opinion includes an extensive discussion of the history and current state of the law of indemnification. *Id.* at 353–55.

[14] *See* Advanced Mining Sys., Inc. v. Fricke, 623 A.2d 82, 83 (Del. Ch. 1992) (noting that nearly all public corporations have bylaw provisions extending indemnification rights beyond what is required by statute); *see also* Fasciana v. Elec. Data Sys. Corp., 829 A.2d 160, 170 (Del. Ch. 2003) (noting that without providing for indemnification, it would be difficult for companies to retain high quality directors and officers).

[15] United States v. Stein, 435 F. Supp. 2d 330, 356–67 (S.D.N.Y. 2006).

[16] *See DOJ Corporate Charging Guidelines* § 9-28.730. The prohibition against considering attorneys' fees arrangements was promulgated in direct response to the Second Circuit's decision in *United States v. Stein*, in which the DOJ was found to have denied defendants' due process rights and right to counsel by having pressured their employer to deny the defendants advancement and indemnification. 541 F.3d 130 (2d Cir. 2008).

[17] The most recent version of the SEC Enforcement Manual does not speak to consideration of indemnification and advancement, but the SEC has in the past explicitly stated that its enforcement decisions have been affected by companies' advancement and indemnification of attorneys' fees. *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, Lucent Settles SEC Enforcement Action Charging the

Finally, even if there is no regulatory pressure to deny advancement of legal fees to former management, the company in crisis may face public or Congressional pressure to do so, especially if, as in the recent financial crisis, taxpayer funds have been used to "bail out" the company. Indeed, calls for the denial of the advancement of legal fees are the logical outgrowth of demands that executive compensation be clawed back, which has become a cause *du jour*. There are many good reasons, however, for the company to stand resolute and resist that pressure. First, when the terms of the corporate charter or employment agreement are unambiguous, the company faces increased litigation risk and exposure in refusing to advance fees. Indeed, directors of companies that improperly refuse advancement may find themselves liable for corporate waste in opposing legitimate requests for advancement.[18] Second, even when there may be a technical defense against advancement because an individual has requested fees to cover the costs of responding to regulators or Congressional inquiries when no formal claim has been made, the failure to pay for experienced counsel for individuals who are appearing before Congress and regulators will greatly complicate the task of corporate counsel in coordinating a unified defense and in receiving timely updates about the status of regulatory investigations.

§ 11.04 Responding to Regulatory Investigations: Cooperating While Preserving Privilege

A company in crisis is almost always addressing ongoing investigations by regulators. To survive the crisis, there may be no choice but to cooperate. This is especially true for companies in the financial sector. And formal guidelines by the DOJ and the SEC—as well as the federal sentencing guidelines—place a powerful premium on a company's cooperation in weighing regulatory action.[19] But how far must cooperation go? Must a company waive attorney-client and other privileges (which defense counsel will certainly seek to preserve) in order to get credit for cooperation?

Beginning in 1999, the DOJ issued a series of memoranda describing DOJ policy

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Company with $1.1 Billion Accounting Fraud (May 17, 2004), *available at* http://www.sec.gov/news/press/2004-67.htm (noting that penalty for failure to cooperate was based in part on company's decision to expand scope of indemnification when not required to do so by law or contract).

[18] *See* Barrett v. Am. Country Holdings, Inc., 951 A.2d 735, 746–47 (Del. Ch. 2008) (noting that stockholders get it "coming and going" when companies refuse to honor advancement obligations and suggesting likelihood of shareholder lawsuit alleging corporate waste against directors and officers who frivolously refuse to advance when obligated). For additional notes on Delaware case law relating to advancement and indemnification, *see* Andrew M. Johnston, et al., *Recent Delaware Law Developments in Advancement and Indemnification: An Analytical Guide*, 6 N.Y.U.J.L. & BUS. 81 (2009).

[19] *See DOJ Corporate Charging Guidelines* § 9-28.700 ("In determining whether to charge a corporation and how to resolve corporate criminal cases, the corporation's timely and voluntary disclosure of wrongdoing and its cooperation with the government's investigation may be relevant factors."); Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969 [2001–2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,985 (October 21, 2001) [hereinafter *Seaboard Report*], *available at* http://www.sec.gov/litigation/investreport/34-44969.htm/ (noting that the SEC considers the company's cooperation in determining whether to take action against the company); *SEC Enforcement Manual* §§ 4, 6; U.S. Sentencing Guidelines Manual ch. 8 (2011).

with regard to charging guidelines for corporate prosecution. The early guidelines required prosecutors to "consider the willingness of a corporation to waive [work product and attorney-client] protection when necessary to provide timely and complete information as one factor in evaluating the corporation's cooperation."[20] Although subsequent memoranda prohibit the DOJ from requesting a waiver of "core" attorney-client communications, including attorneys' notes or memoranda of internal investigation interviews, the most recent guidelines still allow the prosecutor to request and consider whether the company discloses the underlying facts, even if the company's lawyers uncover those facts during an internal investigation.[21]

The SEC has also issued guidance that addresses the scope of a corporation's cooperation and how it will be measured.[22] With respect to the waiver of privilege, the SEC guidelines, like the DOJ Corporate Charging Guidelines, differentiate between "core" attorney work-product and attorney-client communication and the underlying facts. The SEC Guidelines provide that, while "the corporation need not necessarily produce, and the staff may not request without approval, protected notes or memoranda generated by the attorneys' interviews" to receive full cooperation credit, the company must produce, "and the staff always may request, relevant factual information-including relevant factual information acquired through [privileged attorney] interviews."[23]

If the company provides privileged materials to regulators, it will likely face the argument in the securities class-action lawsuit that the privilege has been waived.[24] The rule in most jurisdictions is that the voluntary disclosure of privileged materials to third parties, including the government, waives privilege for those materials.[25] In fact, Congress rejected an SEC-proposed amendment to the Exchange Act that would have established a selective waiver rule regarding documents disclosed to the SEC.[26]

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[20] Mem. from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Attorneys, regarding Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm; *see also* Mem. from Eric Holder, Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Attorneys, regarding Federal Prosecution of Corporations (June 16, 1999).

[21] *DOJ Corporate Charging Guidelines* § 9-28.720.

[22] *See Seaboard Report* at n.3; *SEC Enforcement Manual* §§ 4, 6.

[23] *SEC Enforcement Manual* § 4.3. A staff member is not to ask a party to waive privilege or work product protection unless such request is reviewed by senior members of management and then approved by the Director or Deputy Director. *Id.*

[24] In fact, as discussed in more detail below, plaintiffs may argue that the PSLRA stay of discovery should be lifted based on the corporation providing documents to the government. *See infra* § 11.05 (discussing the PSLRA stay of discovery).

[25] *In re* Initial Pub. Offering Sec. Litig., 249 F.R.D. 457, 460 (S.D.N.Y. 2008) (*citing* Salomon Bros. Treasury Litig. v. Steinhardt Partners, L.P. (*In re* Steinhardt Partners, L.P.), 9 F.3d 230, 235 (2d Cir. 1993) *and* United States v. Nobles, 422 U.S. 225, 239 (1975)).

[26] SEC Statement in Support of Proposed § 24(d) of the Securities and Exchange Act of 1934, in 16 Sec. Reg. & L. Rep. at 461 (Mar. 2, 1984), *cited in* Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414, 1427 (3d Cir. 1991).

While most courts reject the doctrine, at least one Circuit has recognized the doctrine of "selective waiver," whereby waiver of privilege to the government does not constitute waiver to third parties, such as private litigants.[27] Some courts, while rejecting arguments of selective waiver, have refused to adopt a per se rule against its application in all circumstances.[28] For example, selective waiver may be appropriate[29] where "the disclosing party and the government . . . share a common interest in developing legal theories and analyzing information."[30]

Some courts, including the Second Circuit, have suggested that selective waiver may be appropriate when the parties have a confidentiality agreement.[31] Such agreement would, however, likely need to be entered as an order by a court to be effective.[32] Indeed, Federal Rule of Evidence 502 states that a confidentiality

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[27] *See* Diversified Indus. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1977); *see also In re* Pac. Pictures Corp., 679 F.3d 1121 (9th Cir. 2012) (noting that the theory of selective waiver, while initially accepted by the Eighth Circuit, has been "rejected by every other circuit to consider the issue since" and collecting cases).

[28] *See Steinhardt*, 9 F.3d at 236; *In re Initial Public Offering Sec. Litig.*, 249 F.R.D. at 464.

[29] *Steinhardt*, 9 F.3d at 236 ("Establishing a rigid rule [against selective waiver] would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials."). It is not clear whether the Model Confidentiality Agreement included in the *SEC Enforcement Manual* would be sufficiently explicit to meet the requirement suggested in *Steinhardt*. *SEC Enforcement Manual § 4.3.1*. Note that pursuant to the newly enacted Federal Rule of Evidence 502, *infra*, the agreement would likely be effective if entered pursuant to a court order. Fed. R. Evid. 502(d). Of course, this does little good if the SEC demands documents before it brings a federal suit in which the parties can submit such an order. *Steinhardt* also contemplates that a company may preserve privilege after disclosing materials to the government when the company clearly documented cooperation and common interest with the regulator, such as working together to discipline a rogue employee. *Steinhardt*, 9 F.3d at 236. Finally, the SEC itself has supported the confidential treatment in court of materials provided to it under confidentiality agreements. *See, e.g.*, Brief of SEC as Amicus Curiae, McKesson Corp. v. McCall, No. 03-10511 (9th Cir. Filed Feb. 6, 2004), *available at* http://www.sec.gov/litigation/briefs/mckesson.htm.

[30] *Steinhardt*, 9 F.3d at 236.

[31] *Compare In re Initial Public Offering Sec. Litig.*, 249 F.R.D. at 466 (finding that "repeated voluntary disclosures to adversarial parties" precluded finding of selective waiver, despite existence of confidentiality agreements) *with* Gruss v. Zwirn, 276 F.R.D. 115, 142 (S.D.N.Y. 2011) (collecting cases and holding that when "defendants' limited disclosures to the SEC were pursuant to an express confidentiality agreement" and "the absence of any other circumstances arguing in favor of a subsequent waiver," the "defendants' disclosures to the SEC [did not] result[ ] in a waiver of the privilege"); *see also Steinhardt*, 9 F.3d at 236 ("Establishing a rigid rule [against selective waiver] would fail to anticipate situations in which the disclosing party and the government may share a common interest in developing legal theories and analyzing information, or situations in which the SEC and the disclosing party have entered into an explicit agreement that the SEC will maintain the confidentiality of the disclosed materials."). *Steinhardt* also contemplates that a company may preserve privilege after disclosing materials to the government when the company clearly documented cooperation and common interest with the regulator, such as working together to discipline a rogue employee. 9 F.3d at 236.

[32] *See* Fed. R. Evid. 502(d)–(e).

agreement is effective only if entered as an order by the court.[33]

§ 11.05 Impact on the PSLRA Automatic Stay of Discovery

A company in crisis is likely to be required early on to produce documents to regulators and Congress. This leaves the company particularly vulnerable to a motion by plaintiffs in the securities class action for lifting the Private Securities Law Reform Act's ("PSLRA") automatic stay of discovery pending the resolution of a motion to dismiss, so that plaintiffs can quickly obtain the same materials produced by the company to regulators and Congress. The PSLRA provides an exception to the mandatory stay when the plaintiff's request is "particularized" and is necessary to either "preserve evidence" or to avoid "undue prejudice" to the plaintiff.[34] Unfortunately, circuit courts have not provided guidance on this exception, and district court opinions are divided over the meaning of "undue prejudice."[35] Courts have generally been circumspect about lifting the stay and frequently rejected the argument advanced by class-action plaintiffs that when a defendant had already produced documents to regulators, providing those same documents to the plaintiff was not a burden and that a failure to lift the stay to allow for this production unfairly disadvantaged the class plaintiffs when compared with plaintiffs in accompanying derivative and ERISA actions.[36] However, some courts have found that the exception is satisfied when a company has already produced documents to the government or Congress, especially when there are pending actions arising out of the same subject matter.[37]

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[33] Fed. R. Evid. 502(d)–(e). Interestingly, the Advisory Committee explicitly rejected including a rule incorporating the selective waiver doctrine. Fed. R. Evid. 502 advisory committee note; Proposed Amendment to the Federal Rules of Evidence 502(c), attached to May 15, 2006 Advisory Committee on Evidence Rules, *Report of the Advisory Committee on Evidence Rules*, *available at* http://www.klgates.com/files/upload/eDAT_ER_502.pdf. *See also* Lee H. Rosenthal, Chair, Committee on Rules of Practice and Procedure, Judicial Conference to Senators Leahy and Specter, at 6–7 (Sept. 26, 2007).

[34] 15 U.S.C. §§ 77z-1(b)(1); 78u-4(b)(3)(B).

[35] The only legislative guidance about what these terms mean is the statement in the Congressional report that the stay should be lifted for the deposition of a terminally ill witness. *See* Faulkner v. Verizon Communs., Inc., 156 F. Supp. 2d 384, 402 (S.D.N.Y. 2001) (*quoting* S. Rep. No. 104-98, at 14 (1995), reprinted in 1995 U.S.C.C.A.N. 679)).

[36] *See generally* Matthew L. Mustokoff, *Shareholder Discovery, The PSLRA and SLUSA in Parallel Securities and Derivative Actions*, 35 SEC. REG. L.J. 143 (2007). *See also In re* Refco, Inc. Sec. Litig., 05 Civ. 8626 (GEL), 2006 U.S. Dist. LEXIS 55639, at *6 (S.D.N.Y. Aug. 8, 2006) ("Whether PSLRA plaintiffs should be subjected to a discovery stay while other parties, who are bringing claims under other causes of action, are not subjected to a stay is a question for Congress, and one that Congress has answered. . . . The discrepancy . . . is evidence of Congress's judgment that PSLRA actions should be treated differently than other actions.").

[37] *In re* Bank of Am. Corp. Sec., No. 09 MDL 2058 (DC), 2009 U.S. Dist. LEXIS 108322 (S.D.N.Y. Nov. 16, 2009); *In re* WorldCom, Inc. Sec. Litig., 234 F. Supp. 2d 301, 305 (S.D.N.Y. 2002) (lifting stay because "[w]ithout access to documents already made available to the U.S. Attorney, the SEC, and in whole or in part to WorldCom's Creditors Committee and the documents that will in all likelihood be in the hands of the ERISA plaintiffs, NYSCRF would be prejudiced by its inability to make informed decisions about its litigation strategy in a rapidly shifting landscape") *see also* Sarah Gold & Richard

§ 11.06 Congressional Inquiries

[1] Responding to Congressional Requests

Congressional inquiries and hearings inevitably follow a crisis. A company in crisis may be compelled to respond to a Congressional committee's requests for documents, and Congressional hearings put enormous pressure on defense counsel and may provide early and free discovery for plaintiffs in the class-action suit.

Is there any way to minimize the disruption or harm to the defense of the securities class action lawsuit caused by Congressional hearings? Unfortunately, there is no easy path. As an initial matter, Congressional requests for documents are likely to be exceedingly broad and unfocused, yet these requests come with the force or threat of a subpoena.[38] Rather than attempt to litigate the scope of such requests, we have found that working with the Committee staff on both sides of the aisle is often the best way forward. Often, the company may offer to make informal presentations to staffers as a first step in educating the Committee and, hopefully, in limiting the scope of demands. It is also theoretically possible that the company may enlist the aid of regulators and prosecutors who may be concerned that an early, public hearing could negatively impact ongoing investigations. But, as one could imagine, the executive branch is quite reluctant to interfere with Congressional inquiries and hearings and may be prohibited by statute from disclosing the existence of an investigation.[39]

Compared to most civil lawsuits, the schedule of a Congressional inquiry and hearing is often abbreviated, thus leaving the company with little time to produce documents and prepare witnesses. And all of the company's dealings with Congress must be accomplished with an eye toward the potential impact on the defense of the securities class action.

[2] Congress and Privilege

No United States court has definitively determined whether the attorney-client

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Spinogatti, *Are the PSLRA Discovery Stay Exceptions Swallowing the Rule?*, N.Y.L.J., Vol. 242, No. 111 (Nov. 9, 2009). *But see* NECA-IBEW Pension Trust Fund v. Bank of Am. Corp., 10 Civ. 440 (LAK) (HBP), 2011 U.S. Dist. LEXIS 149250 (S.D.N.Y. Dec. 29, 2011) (distinguishing *Bank of Am.* and recognizing that an argument that the PSLRA stay should be lifted so that plaintiffs "will be able to plan their litigation strategy and knowledgably investigate the merits of early settlement discussions" is an argument that "can be used in virtually every case subject to the PSLRA and, if accepted, would create an exception that would swallow the PSLRA's automatic discovery stay"); Kuriakose v. Fed. Home Loan Mortg. Co., 674 F. Supp. 2d 483, 489 (S.D.N.Y. 2009) ("the mere fact that government entities have been provided the discovery that the plaintiffs must wait to obtain does not rise to the level of undue prejudice" (citation and quotation marks omitted)).

[38] Eastland v. United States Servicemen's Fund, 421 U.S. 491, 504 (1975) ("The power to investigate and to do so through compulsory process plainly falls within that definition. This Court has often noted that the power to investigate is inherent in the power to make laws because '(a) legislative body cannot legislate wisely or effectively in the absence of information respecting the conditions which the legislation is intended to affect or change.' Issuance of subpoenas such as the one in question here has long been held to be a legitimate use by Congress of its power to investigate.") (citations omitted).

[39] *See* Fed. R. Crim. P. 6(e).

privilege protects witnesses from divulging privileged information to Congress. Members of Congress have consistently claimed that recognition of the attorney-client privilege is at the discretion of Congress and is not a right.[40] This has important implications for waiver of the privilege in later litigation. While "there is no checklist of procedural steps that automatically guarantees preservation of the privilege," some courts have held that preserving the privilege requires standing in contempt of Congress by refusing to comply with the subpoena.[41] As a practical matter, we strongly advise against the production of privileged material given that the law is unsettled as to whether production of documents to Congress waives privilege or work-product protection, and the production will certainly be used by opposing counsel to argue waiver in any subsequent litigation.[42]

[3] Congressional Testimony

Defense counsel must be intimately involved in preparing key witnesses for Congressional testimony, which will be a matter of public record, taken under oath, and of obvious interest to class-action plaintiffs. Typically, a witness has the opportunity to submit a prepared statement before the hearing that will be made part of the Congressional record. Like a preliminary statement in a motion to dismiss in a securities class-action, the written statement by a company witness must clearly set out

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[40] *See, e.g.*, Rep. Billy Tauzin, H.R. Subcomm. On Telecomm., *Trade & Consumer Protection and Oversight & Investigations of the House Commerce* Committee, 106th Cong. 1384 (Sept. 21, 2000) ("[I]n the courtrooms of America there is such a thing as attorney-client privilege. That does not apply to an investigative committee of Congress. Congress has the right to demand the production of these documents if we so choose, and we reserve the right to do so, of course.") *quoted in* James Cole, et al., *Exploring Every Avenue: The Dilemma Posed by Attorney-Client Privilege Assertions in Congress*, 8 Appalachian J. L. 157 (2008–2009); H.R. Subcomm. on Oversight and Investigations of the Comm. on Energy and Com., *Attorney-Client Privilege: Memoranda Opinions of American Law Division*, Library of Congress, 98th Cong. 1st Sess. (1983) (statement of Rep. John Dingell) ("the position of the subcommittee has consistently been that the availability of the attorney/client privilege to witnesses before it is a matter subject to the discretion of the Chair") *quoted in* Jonathan P. Rich, Note, *The Attorney Client Privilege in Congressional Investigations*, 88 COLUM. L. REV. 145, 159 n.100 (1988).

[41] United States v. Philip Morris, Inc., 212 F.R.D. 421, 425 (D.D.C. 2002); *see, e.g.*, Tompkins v. R.J. Reynolds Tobacco Co., 92 F. Supp. 2d 70, 78 (N.D.N.Y. 2000) the ("mere objections to Congress' refusal to extend a privilege are insufficient" to protect privilege, instead "a party may need to risk standing in contempt by refusing to comply with the subpoena"); Iron Workers Local Union No. 17 Ins. Fund v. Philip Morris, Inc., 35 F. Supp. 2d 582 (N.D. Ohio 1999) ("Generally, a party seeking to preserve a claimed privilege . . . must do more than merely object to Congress' ruling. Instead, a party must risk standing in contempt of Congress."). The D.C. Bar Legal Ethics Committee has opined that "a lawyer's obligations to protect client confidences in the Congressional context are the same as those in the judicial or administrative context," and while "a lawyer has an obligation in the legislative process to raise all available, legitimate objections to a Congressional subpoena for confidential client information," a "lawyer has satisfied his or her personal obligation to maintain client confidences once all objections have been made and exhausted and is not required by the Rules to stand in contempt of Congress if the subcommittee overrules the objections." D.C. Bar Legal Ethics Committee, Ethics Op. No. 288 (1999), *reprinted in* Cole, *supra*.

[42] *See* Anaya v. CBS Broad., Inc., 2007 U.S. Dist. LEXIS 55164 (D.N.M. Apr. 30, 2007) (collecting cases).

the key themes that hopefully will provide an effective response to the crisis and to the litigation claims advanced in the securities class-action lawsuit. A defense counsel who is not closely involved in preparing a witness's statement risks allowing others to control the company's key messages and leaves the witness exposed to making statements that may be imprudent in an environment when the facts are still unfolding.

§ 11.07 Communicating with the Media

In a run-of-the-mill securities class-action scenario, defense counsel and the company are often content with familiar pronouncements to the press, such as, "the claims are without merit" and "the company intends to vigorously contest the claims." With a company in crisis, these standard responses concerning the underlying facts leading to the crisis or to the claims made by plaintiffs and regulators may not be sufficient. Intense pressure will mount to provide meaningful, detailed information. Yet, providing detailed information to the press carries many risks, including the possibility that the company will "get the facts wrong" at an early stage of the crisis, that detailed information will assist the plaintiffs in drafting and supporting their consolidated class action complaint, or that regulators will look askance at disclosures that address (and perhaps prejudice) ongoing investigations.

Because each crisis requires its own, tailor-made press strategy, defense counsel should be intimately involved in the formulation of that strategy and in its implementation. Indeed, it is often the case that defense counsel may be in the best position to provide "off the record" background briefing to reporters to educate the press and ensure more balanced coverage of the crisis.

Frequently, companies in crisis will retain public relations firms to assist in dealing with the media. However, communications between defense counsel and such firms may not be privileged.[43] To increase the possibility of preserving privilege, public relations firms should be retained directly by defense counsel.[44] In some jurisdictions, courts have found that the presence of a public relations professional does not waive privilege when the professional or the firm is so closely tied to the company that it

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[43] *See, e.g.*, Calvin Klein Trademark Trust v. Wachner, 198 F.R.D. 53, 55 (S.D.N.Y. 2000) (distinguishing between work product provided to a public relations firm solely to advance the public image of the company and work product shared with the public relations firm to strategize upcoming litigation and finding waiver as to the former but not the latter). *See also In re* Grand Jury Subpoenas Dated March 24, 265 F. Supp. 2d 321, 326 (S.D.N.Y. 2003) (finding that in some circumstances discussing legal strategy with public relations professionals is necessary to provide effective legal services and finding no waiver of privilege). *But see* Ravenell v. Avis Budget Group, 08-CV-2113 (SLT), 2012 U.S. Dist. LEXIS 48658 (E.D.N.Y. Apr. 5, 2012) (noting that *In re Grand Jury Subpoenas* has "arguably extended the privilege the furthest"). Note that there would be no privilege if the public relations firm was hired for general "spin control" rather than assisting with actual litigation. *Id.*; *see also In re* Copper Mkt. Antitrust Litig., 200 F.R.D. 213, 219 (S.D.N.Y. 2001) (relying on an agency theory to find communications between attorneys and public relations firm privileged and stating that "there is no reason to distinguish between a person on the corporation's payroll and a consultant hired by the corporation if each acts for the corporation and possesses the information needed by attorneys in rendering legal advice.").

[44] *See, e.g.* Tony Anderson, *Roundtable Discussion on Crisis Management*, WIS. L. J., 2004 WLNR 22271000 (Aug. 4, 2004).

could be considered part of the company.[45]

Finally, the company and counsel should be aware that media organizations increasingly attempt to obtain company records submitted to government agencies by using the Freedom of Information Act ("FOIA") or its state-law counterparts.[46] Counsel should follow appropriate procedures for asserting confidentiality with regard to such materials, and should be prepared to object to any potential FOIA production.[47] Often, the agency is willing to extend deadlines and work cooperatively with the business submitter, and, to the extent that the objections are unsuccessful, a delay postponing release of documents until after the motion to dismiss the securities class action has been heard can itself be a small tactical victory.

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[45] *See, e.g.*, *supra* n.40 (discussing *Copper Mkt. Antitrust Litig.*).

[46] 5 U.S.C. §§ 552–53. Many states have similar statutes that apply to state agencies. *See, e.g.*, N.Y. PUB. OFF. LAW, §§ 87–99; Calif. Public Records Act: Gov't Code §§ 6250–6268. A more comprehensive treatment of FOIA procedures and FOIA litigation for the corporation can be found in Thomas M. Susman & Harry A. Hammit, BUSINESS USES OF THE FREEDOM OF INFORMATION ACT (2004). The DOJ, which represents government agencies resisting FOIA demands, has produced a useful guide to this area. *See* U.S. Dep't of Justice, Freedom of Information Act Guide, Exemption 4 (May 2004), *available at* http://www.justice.gov/oip/exemption4.htm.

[47] Generally, agency procedures provide a timeframe during which the following steps occur: (1) the agency notifies the submitter that it may be required to disclose documents that may be covered by Exemption 4 and includes copies of the documents; (2) the submitter notifies the agency as to which documents it believes are exempt from disclosure; (3) if the agency disagrees with the submitters designations, it gives the submitter notice of which documents it has deemed not confidential. *See, e.g.*, 17 C.F.R. § 200.83 (providing procedure for giving SEC submitters notice of requests for confidential information). Note that materials gathered or prepared for the purposes of an SEC investigation are generally exempt from disclosure under FOIA as long as disclosure could reasonably be expected to interfere with enforcement proceedings. *See, e.g.*, Swan v. SEC, 96 F.3d 498, 499–501 (D.C. Cir. 1996) (holding that SEC interview notes of defendants' lawyer made during investigation was exempt from disclosure under FOIA).