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THE INTERPLAY BETWEEN GOVERNMENT INVESTIGATIONS AND CIVIL SECURITIES LITIGATION

A corporation's cooperation with DOJ and SEC investigators can confer significant benefits in resolving criminal and civil enforcement actions, but the required disclosures may fuel follow-on civil suits. The authors discuss this interplay, focusing first on the cooperation required and the risk of waivers of attorney-client privilege and work-product protection. They then turn to the role of the board of directors, and the reverse effect of civil litigation on criminal proceedings.

By Michael M. Farhang and Chris Jung *

A corporation that faces a high-profile investigation by the U.S. Department of Justice, Securities and Exchange Commission, or other law enforcement agency for alleged misconduct or regulatory violations must prepare for the possibility of related civil suits as a part of the potential fallout. While such suits can take varying forms depending on the potential violations at issue – antitrust, false claims, and consumer class actions are some examples – shareholder derivative and class actions are the most common type of civil litigation arising upon disclosure of such investigations. These actions are often filed against companies under investigation even before any finding of wrongdoing by regulators, and in some cases the actions may be numerous. In 2010, for example, after Parker Drilling Company, a global contract drilling and drilling services company, disclosed in its 2009 annual report that it was under investigation by both the DOJ and SEC for potential violations of the Foreign Corrupt Practices Act, four different plaintiffs filed derivative suits in federal and state courts based upon allegations derived from the government investigations.[1] The company ultimately chose to cooperate with the DOJ and SEC investigations and settled charges with both agencies in April 2013.

Because of the potential for parallel civil litigation to follow the public announcement of any government criminal or civil investigation, companies should be prepared to implement an overall responsive strategy that accounts for the various procedural and substantive challenges raised by such parallel proceedings. The reasons for a circumspect approach are more than theoretical: experience has amply demonstrated that

[1] Parker Drilling Co., Annual Report (Form 10-K), at 20 (Dec. 31, 2009); Parker Drilling Co., Annual Report (Form 10-K), at 78 (Dec. 31, 2010) (disclosing the four shareholder derivative suits based on the FCPA investigation).

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civil suits often follow government criminal or civil investigations.[2]

Even if a company is able to avoid criminal or civil liability by cooperating and settling with government authorities, the compound effects of a government investigation and follow-on civil suits can nonetheless still precipitate a chain of events with the potential to damage a company's reputation and commercial viability. In 2013, for example, Groeb Farms, one of the country's largest suppliers of honey, averted criminal liability for its role in illegally buying Chinese-origin honey by reaching a settlement agreement with the DOJ in February 2013. However, by July 2013, two class actions were filed against the company that quoted extensively from facts to which Groeb Farms admitted in its settlement agreement with the DOJ. By October 2013, the company was forced to file for bankruptcy due at least in part to the threat of treble damages liability in the subsequent litigation.[3] An example like this illustrates that some of the steps necessary to resolve a government investigation could potentially have an adverse effect on the defense of private lawsuits, making the strategy for addressing such investigations of paramount importance.

COOPERATION WITH DOJ AND SEC INVESTIGATIONS

A company under federal investigation will often have significant incentives to cooperate with government authorities. Depending upon prosecutive guidelines and the circumstances of any alleged violations, such cooperation can affect whether and how the government makes a decision to bring a criminal or civil charge against the company. The DOJ, for example, emphasizes "timely and thorough" cooperation as a significant factor in its charging decisions.[4] Because it often may be difficult for the DOJ to determine which individuals took certain actions on behalf of a corporation, the corporation's cooperation "may be critical in identifying potentially relevant actors and locating relevant evidence, among other things, and in doing so expeditiously."[5] The corporation can also benefit from cooperation, even apart from leniency considerations, "by enabling the government to focus its investigative resources in a manner that will not unduly disrupt the corporation's legitimate business operations."[6] Similarly, the federal Sentencing Guidelines, which cover the sentencing of corporations for criminal offenses, also contain provisions that promise leniency for corporations that promptly cooperate with government investigations. Under the Guidelines, cooperation is "timely" if the corporation acts "essentially at the same time as [it] is officially notified of a criminal investigation."[7] Cooperation is deemed "thorough" if the corporation discloses all relevant information "sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct."[8]

The SEC's charging guidance places a similarly high premium on corporate cooperation and the SEC has in some cases declined to pursue actions against corporations that "seek out, self-report, and rectify illegal conduct, and otherwise cooperate with

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[2] *Cf.* Jessica M. Erickson, Overlitigating Corporate Fraud: An Empirical Examination, S, 97 Iowa L. Rev. 49 (Nov. 2011).

[3] *Moore v. Groeb Farms, Inc.*, 1:13-cv-02905 (N.D. Ill. April 17, 2013) (citing RICO treble damages under 18 U.S.C. § 1964(c)).

[4] United States Attorneys' Manual § 9-28.700 ("In determining whether to charge a corporation and how to resolve corporate criminal cases, the corporation's timely and voluntary disclosure

footnote continued from previous column…

of wrongdoing and its cooperation with the government's investigation may be relevant factors."); *see also* Federal Sentencing Guidelines Manual § 8C2.5 ¶ 13. The DOJ Corporate Charging Guidelines also sets forth nine factors to be considered when making charging decisions for corporations, including, "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents."

[5] United States Attorneys' Manual § 9-28.700 cmt. B.

[6] *Id.*

[7] Federal Sentencing Guidelines Manual § 8C2.5 ¶ 13.

[8] *Id.*

Commission staff."[9] In 2001, the SEC issued its Seaboard Report, explaining why it was declining to pursue action against a corporation whose management had manipulated its accounting records, issued inaccurate financial reports, and then covered up those facts. In the Seaboard Report, the SEC set forth 13 factors, including whether the company "promptly, completely, and effectively disclose the existence of the misconduct to the public, to regulators, and to self-regulators," and whether the "company voluntarily disclose[d] information our staff did not directly request and otherwise might not have uncovered."[10]

The SEC has demonstrated in practice that proactive self-examination and self-reporting by companies can potentially carry significant benefits. In 2011, for example, the SEC entered into its first deferred prosecution agreement ("DPA") with Tenaris, a steel manufacturing company that self-reported violations found during an internal investigation.[11] More recently, in 2013, Ralph Lauren Corporation entered into non-prosecution agreements ("NPAs") with both the DOJ and SEC after it self-reported violations identified during an internal investigation into alleged bribery conduct.[12] In the Ralph Lauren case, the SEC noted publicly that the company "did the right thing by immediately reporting [violations] to the SEC" and that the settlement "makes clear that we will confer substantial and tangible benefits on companies that respond appropriately to violations and cooperate fully with the SEC."[13] Similarly, the DOJ cited Ralph Lauren's "extensive, thorough, and timely cooperation, including self-disclosure of the misconduct."[14] Conversely, in 2010, telecommunications equipment company Alcatel-Lucent was forced to pay more than $137 million to settle SEC and DOJ charges tied to FCPA violations allegedly resulting from what the SEC described as "a lax corporate control environment" and a failure to "detect or investigate numerous red flags."[15]

In addition to litigation risks that could arise from a corporation's cooperative response to the government, a corporation should also consider the litigation risks presented by responses to the market or general public about the investigation or underlying allegations. A corporation undergoing a DOJ or SEC investigation may run the risk of lawsuits, for example, based on allegations of inaccurate or incomplete disclosures made regarding the nature and scope of the investigation itself. Where securities laws require certain public disclosures of material information – for example, disclosures of certain significant litigation and government investigations in quarterly and annual public filings[16] – material misstatements or omissions contained in those filings could lead to additional potential claims of securities fraud liability for the corporation and its executives, compounding the fallout from the initial issues that prompted the investigation.[17]

While company management may perceive a benefit in making strong public statements denying wrongdoing to address the concerns of the company's stakeholders, including investors, shareholders, lenders, and others, making definitive exculpatory statements about the operative facts before all of those facts are known can be risky, and can also antagonize the government if the DOJ or SEC believe the evidence shows the contrary. For example, in November 2013, SAC Capital Advisors, a large hedge fund, issued a public statement after agreeing to a corporate settlement of insider trading charges with the DOJ. The statement contained the sentence, "SAC has never encouraged, promoted, or tolerated insider trading," which appeared to contradict the company's guilty plea and reportedly drew an adverse reaction from government officials. After that, SAC substituted the following for the prior statement: "Even one person crossing the line into illegal behavior is too many and we greatly regret this conduct occurred."[18]

The disclosures often required by the government as part of a criminal or civil resolution can also present issues for positions the company might take in future litigation. A corporation may be required to make public

[9] SEC Report Of Investigation Pursuant To Section 21(A) Of The Securities Exchange Act Of 1934 and Commission Statement On The Relationship And Cooperation To Agency Enforcement Decisions, Exchange Act Release No. 44969, Accounting and Auditing Enforcement Release No. 1470, October 23, 2001 ("Seaboard Report").

[10] *Id.*

[11] http://www.sec.gov/news/press/2011/2011-112.htm.

[12] http://www.sec.gov/NewsPressRelease/Detail/PressRelease/1365171514780#.UnAqjvk6N8E; http://www.justice.gov/opa/pr/2013/April/13-crm-456.html.

[13] http://www.sec.gov/NewsPressRelease/Detail/PressRelease/1365171514780#.UnAqjvk6N8E.

[14] http://www.justice.gov/opa/pr/2013/April/13-crm-456.html.

[15] http://www.sec.gov/news/press/2010/2010-258.htm.

[16] FASB Accounting Standards Codification § 450.

[17] 17 C.F.R. 240.10b-5; Sarbanes Oxley § 906.

[18] http://dealbook.nytimes.com/2013/11/04/sac-capital-agrees-to-plead-guilty-to-insider-trading/?_r=1&.

statements or admissions about alleged misconduct when it enters into a DPA or NPA with the DOJ or SEC. According to the DOJ, NPAs and DPAs "help restore the integrity of a company's operations and preserve the financial viability of a corporation that has engaged in criminal conduct, while preserving the government's ability to prosecute a recalcitrant corporation that materially breaches the agreement."[19] DPAs and NPAs can become publicly available, however, and can sometimes contain statements of fact that civil plaintiffs may use to form the basis of subsequent lawsuits. For example, only two months after Groeb Farms entered into its DPA with the DOJ in February 2013, the company was named in a class action complaint that quoted extensively from the DPA and alleged that "as part of its deferred prosecution agreement . . . Groeb admitted and agreed to several facts that establish its guilt beyond a reasonable doubt."[20] Given the possibility that settlements may form the basis for civil allegations, care should be given to ensure that disclosures or admissions in agreements with the government are precise and accurate, and do not exaggerate or improperly sensationalize the scope and seriousness of the facts at issue.

ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT PROTECTION

Although cooperation with a government investigation can confer substantial potential benefits on a company in terms of an ultimate resolution, the collateral consequences in follow-on civil suits can impact the company's defense of those actions. In various contexts, both statements *to* the government as well as statements *regarding* the government investigation can impact a company's litigation strategy in pending and future civil suits.

Attorney-client privilege and attorney work-product waivers constitute a critical area for attention. In a situation where a corporation seeks to cooperate with a government investigation, statements and documents supplied to the DOJ or SEC as part of that cooperation may potentially be discoverable in later litigation. If privileged or work-product-protected documents and communications form part of what is provided to the government, these materials could become discoverable if a court determines there has been a waiver of the attorney-client privilege or attorney work-product protection. Because of this possibility, companies must assess the risk that documents and statements provided to the government may be specifically targeted by civil plaintiffs in discovery through document requests, interrogatories, and deposition questions. The types of materials or analysis that the government seeks to advance an investigation can also serve as a roadmap to the evidence or issues for civil plaintiffs in litigation. Furthermore, the facts admitted to in a subsequent DPA or NPA can also become the foundation for subsequent allegations in a civil securities complaint, may inform and guide interrogatories, requests for admissions, and deposition questioning, and could also in some cases constitute party admissions themselves. Thus, corporations must balance carefully the benefits of disclosure and potential prosecutorial leniency with the potential jeopardy to the corporation's subsequent ability to defend itself in parallel and subsequent civil suits.

Attorney-Client Privilege

The attorney-client privilege is designed "to encourage full and frank communications between attorneys and their clients."[21] Courts narrowly construe the privilege because application of the privilege can hinder the search for truth,[22] and disclosing privileged information to a third party outside of the attorney-client relationship can waive the privilege.[23] Although the DOJ's United States Attorney's Manual clarifies that prosecutors are directed not to seek waivers of the attorney-client privilege, it also acknowledges the companies may freely waive the privilege by voluntarily choosing to do so and that such waivers "occur routinely" in cases of employee misconduct where the company is victimized.[24] Because the government is considered a third party for purposes of an attorney-client relationship involving a corporation, the privilege will usually be deemed waived where the corporation produces privileged materials to the government during an investigation.[25] One federal circuit has created a limited exception applicable to government cooperation

[19] Principles of Federal Prosecution of Business Organizations, U.S.A.M.§ 9-28.1000 cmt. b. The SEC began using DPAs and NPAs in January 2010. *See* www.sec.gov/news/speech/2010/spch011310rsk.htm.

[20] *Adee Honey Farms v. Groeb Farms, Inc.*, 1:13-cv-02922 (N.D. Ill. April 18, 2013).

[21] *Upjohn v. United States*, 449 U.S. 383, 389 (1981).

[22] *See, e.g., Fisher v. United States*, 425 U.S. 391 (1976).

[23] *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1424 (3d Cir. 1991).

[24] Principles of Federal Prosecution of Business Organizations, U.S.A.M.§ 9-28.710.

[25] *See In re Pacific Pictures Corp.*, 679 F.3d 1121, 1127 (9th Cir. 2012) (collecting cases).

in certain circumstances: in *Diversified Industries v. Meredith*, the Eighth Circuit adopted a "selective waiver" rule that voluntary disclosures made in cooperation with a government investigation do not waive the privilege because a contrary rule "may have the effect of thwarting the developing procedure of corporations to employ independent outside counsel to investigate and advise them in order to protect stockholders."[26] However, every other federal circuit that has reached the issue has held otherwise.[27] Thus, care should be exercised to ensure that the privilege and work-product protection are maintained as much as possible during cooperation to minimize the chances of a waiver.

One potential alternative to minimize the chance of waiver is for a corporation to stipulate with the government to seek a court order that protects against waiver in the government proceeding and other proceedings as well. Federal Rule of Evidence 502(d) allows a court to "order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court – in which event the disclosure is also not a waiver in any other federal or state proceeding."[28] In *S.E.C. v. Bank of America Corp.*, the district court approved a proposed protective order agreed to by the SEC and Bank of America that sought to "allow the Bank of America to waive attorney-client privilege and work-product protection regarding certain categories of information material to this case (and seemingly also relevant to certain ongoing state and federal inquiries) without thereby waiving such privilege and protection regarding other information that may be of interest in related private suits."[29] A Rule 502(d) order would thus conceivably permit a corporation to provide privileged materials as part of its cooperation with a federal government proceeding without risking waiver of the attorney-client privilege or work-product protection in that or other proceedings.

A corporation's disclosure responsibilities to other third parties, including outside auditors and lenders, during a government investigation may also present waiver issues. The attorney-client privilege is typically deemed waived when privileged corporate communications are shared with third parties like a corporation's external auditors, even if those disclosures are required to comply with an independent outside audit.[30] Disclosure of documents to an outside accountant can "destroy[] the confidentiality seal required of communications protected by the attorney-client privilege," despite the fact that the federal securities laws require public companies to have an independent audit.[31] Disclosures to other third-party constituencies, such as lenders, can have a similar result.[32]

Work-Product Protection

Attorney work-product protection should also be considered when responding to government investigations because of the potential for waiver. While the attorney-client privilege protects confidential communications between a corporation and its attorneys, the work-product doctrine can be somewhat broader in scope: its purpose is to preserve the integrity of the adversarial system by preventing a litigant from taking a free ride on the work performed by an opposing attorney.[33] The Supreme Court created the doctrine in *Hickman v. Taylor* to protect work-product reflected in "interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and

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[26] *Diversified Indus. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1978) (en banc).

[27] *In re Pacific Pictures Corp.*, *supra* note 25 (collecting cases).

[28] Fed. R. Evid. § 502(d).

[29] *S.E.C. v. Bank of America Corp.*, 1:09-cv-06829-JSR (Oct. 14, 2009).

[30] *In re Pfizer Sec. Litig.*, No. 90 Civ. 1260 (SS), 1993 WL 561125, at * 7 (S.D.N.Y. Dec. 23, 1993) (stating that "Pfizer cannot assert attorney-client privilege for any documents that were provided to its independent auditor"); *see also United States v. El Paso Co.*, 682 F.2d 530, 540 (5th Cir. 1982) (finding no attorney-client privilege for documents provided to external auditors). In light of the tension created by the financial transparency required by auditors but the confidentiality needed by lawyers, the two professions entered into a Treaty by seeking to minimize waiver caused by external audits. *See* Exhibit II – American Bar Association Statement Of Policy Regarding Lawyers' Responses to Auditors' Requests for Information, Statement on Auditing Standards No. 12, § 337C (Am. Inst. of Certified Pub. Accountants 1976).

[31] *In re Pfizer Sec. Litig.*, No. 90 Civ. 1260 (SS), 1993 WL 561125, at * 7 (S.D.N.Y. Dec. 23, 1993).

[32] *Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A.*, 160 F.R.D. 437, 448 (S.D.N.Y. 1995) ("Generally, disclosure to *any* third party will constitute waiver of the attorney-client privilege.") (emphasis added); *Randleman v. Fidelity Nat'l Title Ins. Co.*, 3:06-cv-07049 (N.D. Ohio, July 25, 2008) ("Defendant waived the privilege because the counsel's advice and documents were discussed with agents, brokers and lenders – third parties to the suit.").

[33] *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

countless other *tangible and intangible ways*."[34] There are typically two different recognized categories of work-product subject to protection: fact work-product and opinion work-product. Under the Federal Rules of Civil Procedure, for example, fact work-product, which consists of factual information gathered in preparation for litigation, receives qualified protection: an opposing party can seek discovery of the materials if it can demonstrate a "substantial need."[35] Opinion work-product – an attorney's mental impressions, opinions, and theories – receives absolute protection and is never discoverable.[36]

Attorney work-product can also receive protection even where it is not actually created by an attorney – the primary requirement is that the work be prepared "in anticipation of litigation"[37] and at the direction of an attorney.[38] Most circuits have held that work is prepared in anticipation of litigation if it is created "because of" litigation, providing a lower threshold that can be met even where litigation is not currently in progress.[39] Under the federal standard, documents created for both business and litigation purposes can be protected.[40] In the context of an investigation, a corporation's inside or outside counsel will usually assert the protection on behalf of the company in an investigation or civil litigation.[41]

Although the requirements for waiver of attorney work-product protection are different than those for waiver of the attorney-client privilege, disclosures to the government may present the same waiver risks where work-product protection is concerned. The DOJ takes a position that prosecutors should not request waivers of attorney work-product protection, but acknowledges that companies may freely choose to make such waivers as part of cooperation.[42] Unlike the attorney-client privilege, which is waived upon disclosure to any third party, work-product protection is waived when the work is disclosed in a way that "substantially increases the opportunity for a potential adversary to obtain the information."[43] Courts have typically deemed work-product protection to have been waived when materials are produced to the government in cooperation with an investigation.[44] As the Third Circuit has explained, the production of materials to a government agency during an investigation is intended to forestall prosecution or obtain lenient treatment, purposes "foreign to the objectives underlying the work-product doctrine," which is directed at the adversarial litigation process.[45] On the other hand, a number of federal decisions have held that external auditors are not a "potential adversary" and that work-product protection is not necessarily waived when

[34] *Hickman v. Taylor*, 329 U.S. 495, 511 (1947) (emphasis added); *United States v. Nobles*, 422 U.S. 225 (1975) (applying *Hickman* to criminal cases).

[35] Rule 26(b)(3)(A).

[36] Rule 26(b)(3)(B).

[37] Fed. R. Civ. P. 26(b)(3).

[38] *In re Grand Jury Proceedings*, No. M-11-189, 2001 WL 1167497, at *19 (S.D.N.Y. Oct. 3, 2001) (no work-product protection for work done "independently rather than under any attorney's direction and control"). *But see Caremark, Inc. v. Affiliated Computer Servs., Inc.*, 195 F.R.D. 610, 615 (N.D. Ill. 2000) (providing protection for materials prepared in anticipation of litigation "regardless of whether the representative is acting for the lawyer").

[39] *See Adlman v. United States*, 134 F.3d 1194, 1197 (2d Cir. 1998) (creating "because of" standard); 8 Charles Alan Wright, Arthur R. Miller & Richard L. Marcus, Federal Practice and Procedure, ¶ 2024 (2d ed. 2009) (work-product doctrine should protect work-product created prior to claims being brought because "prudent parties anticipate litigation and begin preparation prior to the time suit is formally commenced").

[40] *Id.* at 1200 (2d. Cir. 1998) ("We see no basis for adopting a test under which an attorney's assessment of the likely outcome of litigation is freely available to his litigation adversary merely because the document was created for a business purpose rather than for litigation assistance."). Two other circuits have set a higher bar for work-product protection: the Fifth Circuit has adopted a more stringent "primary purpose" standard, while the

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First Circuit recently created a new "for use in litigation" standard; *see United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982); *United States v. Textron*, 577 F.3d 21 (1st Cir. 2009).

[41] *See In re Doe*, 662 F.2d 1073, 1079 (4th Cir. 1981) (finding that the work-product doctrine can be invoked by either the client or the attorney).

[42] Principles of Federal Prosecution of Business Organizations, U.S.A.M.§ 9-28.710.

[43] *In re Pfizer Sec. Litig.*, No. 90 Civ. 1260 (SS), 1993 WL 561125, at * 6 (S.D.N.Y. Dec. 23, 1993).

[44] *See, e.g.,United States v. Massachusetts Institute of Technology*, 129 F.3d 681, 687 (1st Cir. 1997); *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1429 (3d Cir. 1991).

[45] *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1429 (3d Cir. 1991).

a corporation discloses work-product regarding investigation of allegations to its external auditors.[46]

THE ROLE OF THE BOARD OF DIRECTORS

Because the outcome of a government investigation may depend in part on its assessment of the nature and quality of a corporation's cooperation – and in particular the credibility of its internal investigation and subsequent self-disclosure – who leads and oversees the corporation's internal investigation can be critical for making the ultimate case for valuable cooperation. Management-led internal investigations, for example, may be proper in instances where the criminal violations are of a non-routine nature perpetrated by low- or mid-level employees. An internal investigation run by independent directors or committees of the board, however, may be appropriate when the alleged conduct is serious and such independence is seen as vital to the integrity of the investigation. This might be the case, for example, when high-level executives are implicated, when the alleged violations are systemic to the company's business operations, or when employees are unwilling to cooperate because they fear retaliation from management. Because a board of directors has the general authority (and fiduciary duties) to act in the best interests of the corporation and does not answer to management within the corporate hierarchy, a committee of disinterested directors is often considered an appropriate body to oversee an internal investigation that seeks to identify, rectify, and perhaps even self-report certain types of serious and significant potential criminal violations.[47]

The Board's Role in a Government Investigation

Both the DOJ and SEC have publicly praised internal investigations led by disinterested directors as an important component of corporate cooperation, even where the illegal conduct reached the highest levels of the company. Government regulators may view the fact that a board is leading an investigation as an indication that the company is taking allegations seriously and is willing to commit attention and resources at its highest levels. In addition, the DOJ and SEC are less likely to view a company's internal investigation as compromised by self-interest where it is run by outside directors who are not implicated in any of the investigation issues and do not answer to executives who may be. For example, the SEC declined to bring an action in 2006 against Putnam Fiduciary Trust Company for allegedly defrauding a client of approximately $4 million, even though six of its high-level executives were individually charged with fraud, because the company's "swift, extensive, and extraordinary cooperation" included an independent internal investigation, the results of which were shared with the SEC.[48] Similarly, the DOJ entered into a DPA in 2004 with Computer Associates International, Inc. in part because the company empowered its audit committee to conduct a wide-ranging independent investigation into its officers and employees.[49]

In the context of an independent board- or committee-led investigation, the dissemination of results requires some care to avoid waiver problems. In limited cases, waiver has been held to have occurred where officers or directors who are potentially implicated in the alleged violations were privy to privileged communications about the internal investigation process. In *Ryan v. Gifford*, for example, a Delaware court held that participation by implicated directors of Maxim Integrated Products, Inc. in a special committee's privileged communications about its investigation of alleged stock option manipulation resulted in a waiver of the corporation's attorney-client privilege over the investigation report.[50] The *Ryan* court concluded that the potential for personal liability of the directors meant that their interests were not aligned with those of the corporation and thus sharing privileged information with them fell outside the confidential attorney-client relationship. While it is not clear how broadly a holding like that in *Ryan* can be applied to other cases, some attention to the risks of dissemination of independent

[46] *United States v. Deloitte*, 610 F.3d 129, 139 (D.C. Cir. 2010) (stating that no federal circuit court has found waiver by disclosure to external auditors). *But see Medinol v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002) (finding waiver because "good auditing requires adversarial tension between the auditor and the client").

[47] R. Franklin Balotti & Jesse A. Finkelstein, Delaware Law of Corporations and Business Organizations, § 4.14 (2013) ("The board of directors is responsible for managing the corporation's business and affairs for the benefit of the shareholders.").

[48] http://www.sec.gov/news/press/2006-2.htm.

[49] *United States v. Computer Associates Int'l, Inc.*, Cr. No. 04-837 (E.D.N.Y. Sept. 22, 2004).

[50] *Ryan v. Gifford*, 2007 WL 4259557, at *3 (Del. Ch. Nov. 30, 2007). On appeal, the Delaware court explained that waiver of attorney-client privilege "would not apply to a situation (unlike that presented in this case) in which board members are found to be acting in their fiduciary capacity, where their personal lawyers are not present, and where the board members do not use the privileged information to exculpate themselves." *Ryan v. Gifford*, 2008 WL 43699, at * 5 (Del. Ch. Jan. 2, 2008).

investigation materials, even within the company, is nonetheless prudent.

The Board's Role in a Derivative Suit

In a shareholder derivative suit, the independence and disinterestedness of the corporation's board of directors also takes on significance because these qualities can form part of the key threshold inquiry in such a suit, and they can make the difference between a swift and successful motion to dismiss and protracted, costly litigation for the corporation and its management. Because basic principles of corporate governance dictate that the decisions of a corporation, including the decision to initiate litigation, should be made by the board, in many jurisdictions – including Delaware, a state in which many corporations are incorporated and whose law forms the basis for internal legal relationships at such corporations – a shareholder attempting to bring a derivative suit on behalf of the corporation must first satisfy stringent pleading standards justifying the attempt to supplant the board's authority to manage the corporation's claims.[51] In cases involving Delaware corporations, for example, the shareholder must either: (1) make a pre-suit demand upon the board requesting that they bring suit and show that the board wrongfully refused to do so; or (2) plead particularized facts showing that demand upon the board would have been futile (and was therefore excused) because the facts suggest a reasonable doubt as to the board's disinterestedness or independence, or the decision's rational business judgment.[52] Derivative shareholder demands are rare because a board's decision to reject the demand is subject to the business judgment rule, an extremely strong presumption in favor of the board that a plaintiff cannot rebut unless it shows that the decision is completely devoid of rational explanation.[53] Most derivative plaintiffs seek to avoid the business judgment presumption by instead arguing that demand was excused because it would have been futile.

In a derivative suit stemming from alleged criminal or civil violations that are the subject of a DOJ or SEC investigation, a plaintiff will often charge that the board is compromised in its ability to handle a demand because of its alleged failure to adequately monitor and oversee corporate activities and thus prevent misconduct. Assuming that the directors are not themselves alleged to have participated in the misconduct, plaintiffs may be able to plead a reasonable doubt as to disinterestedness where the directors' alleged failure of oversight was "so egregious on its face" that there is a substantial likelihood that the directors will be held personally liable for their inaction.[54] Most plaintiffs cannot clear this high hurdle because it requires "a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system."[55] As an example, in a case involving Abbott Laboratories, the Seventh Circuit held that this burden was met where the plaintiff alleged an extensive paper trail demonstrating that the directors knew of but took no action to rectify several years of criminal violations that ultimately led to the largest penalty ever imposed by the federal Food and Drug Administration.[56]

Even if a derivative plaintiff successfully pleads demand futility, the corporation can potentially stave off the derivative suit by subsequently establishing a special litigation committee of the board that is empowered to conduct an internal investigation to determine whether the board should bring a suit on behalf of the corporation.[57] The key inquiry regarding the special litigation committee is its independence – the corporation has the burden of establishing the special committee's independence to the court, so the corporation must carefully select the special litigation committee so that none of its members have any financial, personal, or even social interests that would lead a court to question their independence.[58] If the court finds that the special committee is sufficiently independent, the committee – and not the derivative plaintiff – retains the authority to determine whether a suit should be brought on behalf of the corporation. The

[51] *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 101 (1991).

[52] *In re Citigroup*, 964 A.2d 106, 120 (Del. Ch. 2009).

[53] *Spiegel v. Buntrock*, 571 A.2d 767, 776 (Del. 1990).

[54] *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984); *Rales v. Blasband*, 634 A.2d 927, 934-6 (Del. 1993); *Guttman v. Huang*, 823 A.2d 492, 499 (Del. Ch. 2003) (*Rales* standard applies to claims alleging that directors breached fiduciary duties by failing to ensure compliance with applicable accounting standards).

[55] *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006); *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

[56] *In re Abbott Laboratories Deriv. Litig*., 325 F.3d 795, 809 (7th Cir. 2003).

[57] *Zapata v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981); *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 939-40 (Del. Ch. 2003).

[58] *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 937-38 (Del. Ch. 2003).

court will then examine whether the committee's investigation was taken in good faith, and whether or not the committee's decision to bring a suit was reasonable.[59] The court may also apply its own business judgment to the board's decision.[60] If the court determines these questions in the committee's favor, the corporation's motion to dismiss the plaintiff's action may be granted. Because of the importance of the special committee's good faith and independence to this determination, care should be taken to ensure that the work of the special committee will not ultimately be subject to challenge either because of allegations made by the government in a regulatory matter or disclosures by the company as part of its cooperation with a government investigation.

The Board's Role in a Securities Class Action

Another type of possible directorial responsibility – authorizing the company's public disclosure of certain facts relating to a government investigation in SEC filings or elsewhere – may also have ramifications in the civil class action context. Unlike a shareholder derivative action, a securities class action seeks to enforce the rights of a class of shareholders, not the corporation. A corporation, its officers, or its directors could potentially face shareholder suits based on materially false statements made to the market before, during, and after a government investigation with respect to the issues under investigation. A follow-on class action may allege, for example, that the corporation and its executives knowingly made material misstatements or omissions about either critical facts underlying the investigation or about the investigation itself, and that this fraud artificially inflated the share price of the company until the public knowledge of the "true facts" of the government investigation caused a drop in share price that injured the corporation's shareholders, who had not been provided materially complete and accurate information.

A key inquiry in such a case will often be whether a board or individual director is in fact a "maker" of those statements. The Supreme Court's 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders* held that the "maker" of a statement is the person with "ultimate authority over the statement, including its content and whether and how to communicate it."[61]

After *Janus*, some federal courts have held that any person who signs an SEC filing is a "maker" of the statements contained in the filing for purposes of Rule 10b-5. Where a corporation's annual Form 10-K, for example, is signed by the CEO, CFO, and a majority of the board of directors as required,[62] a class action complaint may allege that each of these individuals can be held liable for securities fraud liability based upon material false statements or omissions in those annual reports.[63]

Although securities fraud claims may arise as a result of statements made during a government investigation, there are substantial procedural hurdles that may work to the advantage of a company defending such claims. In the federal securities class action context, director defendants enjoy the benefit of heightened pleading standards and some protections from early discovery. A securities class action brought under Rule 10b-5 is subject to the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which was enacted to curb "abusive practices committed in private securities litigation." The PSLRA imposes a heightened pleading requirement that requires the plaintiff to plead particularized facts regarding the allegedly false statements as well as particularized facts giving rise to a "strong inference" of scienter, *i.e.*, the defendant's knowledge that the statement was false.[64] In many cases, it may be difficult for a civil plaintiff who lacks the formidable pre-filing discovery mechanisms available to the government to gather sufficient facts to plead the scienter of various defendants, especially directors who are often removed from the day-to-day management of the company.[65] This is especially true if the government's investigation has not yet resulted in charges because the government's investigative file is unlikely to be accessible to civil plaintiffs. Further complicating the pleading burden for plaintiffs even after they file a complaint, the PSLRA also imposes a discovery stay in private actions brought

[59] *London v. Tyrell*, 2010 WL 877528, at *1 (Del. Ch. Mar. 11, 2010).

[60] *Zapata*, *supra* note 57 at 789.

[61] *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296, 2302 (2011).

[62] Form 10-K filing instructions *at* http://www.sec.gov/about/forms/form10-k.pdf.

[63] *In re Smith Barney Transfer Agent Litig.*, 884 F.Supp.2d. 152, 163-64 (S.D.N.Y. 2012) (collecting cases); *S.E.C. v. Das*, 2011 WL 4375787, at *6 (D. Neb. 2011).

[64] 15 U.S.C. §§ 78u-4(b)(1) - (2).

[65] In cases involving corporations incorporated in certain states where stockholders have the ability to make pre-filing records demand for a proper purpose, *e.g.*, shareholder books and records demands pursuant to Delaware General Corporations Law Section 220, such vehicles may provide a means to obtain some internal corporate information that can inform a complaint.

under the federal securities laws where a motion to dismiss is filed.[66] Such discovery stays can make it more difficult for plaintiffs to overcome the considerable pleading hurdles and may reduce the pressure on company defendants to seek an early settlement.

CIVIL LITIGATION AND POSSIBLE EFFECTS ON GOVERNMENT INVESTIGATIONS

Although there are numerous ways in which a government investigation can impact future civil litigation, civil securities litigation can also have a significant impact on the course and outcome of a related government investigation. Because civil plaintiffs can avail themselves of a number of discovery mechanisms not necessarily available to criminal prosecutors, such as pre-trial depositions, interrogatories, and requests for admissions, parallel civil proceedings may create a dynamic in which the government can derive added leverage from the existence of a parallel civil action spearheaded by an aggressive plaintiff. Civil plaintiffs, for example, may seek to supply the government with helpful evidence obtained during the discovery process in order to advance the government's criminal investigation and increase the pressure on the corporate defendant. A plaintiff in a related civil suit, for example, will likely seek depositions of key officers and directors during the discovery process, and may be in a position to provide resulting transcripts of testimony or documents to the DOJ or SEC, either voluntarily where no protective order is in force or where permitted in response to a government subpoena. The SEC and other civil enforcement agencies can also take depositions and later provide such materials to criminal authorities where a legitimate law enforcement interest exists.[67] Such assistance may help the government understand key facts, identify potential additional witnesses and sources of information, and compare the statements made at deposition to those made to the government. Thus, a corporation facing parallel litigation can end up effectively confronting two sets of "prosecutors": criminal and civil enforcement authorities on the one hand, and private civil plaintiffs who are using the discovery process to aid the government's criminal investigation.

Conversely, parallel civil proceedings can also pose substantial risks to the government as well because a corporate target may also be in a position to use the civil discovery process to obtain valuable information that government prosecutors may want to shield until an indictment can be brought and criminal discovery takes place. For example, a criminal case against a corporation may hinge upon the credibility of a key witness, such as a whistleblower, a disgruntled employee, or an implicated executive who will testify in exchange for leniency. In the absence of civil litigation, a target in the criminal investigation would not necessarily have access to the key witnesses in order to test their stories and attack their credibility. Where a related civil proceeding names as defendants those key targets in the criminal investigation (*e.g.*, a company or its executives) and puts facts at issue that are similar to those in the criminal investigation, the corporate targets will have an opportunity through counsel to use subpoenas and other process to depose the witnesses, assess the credibility of their stories, develop a factual record to impeach credibility, and begin to develop and advance defense theories.

In cases where the DOJ perceives that parallel civil proceedings may jeopardize an ongoing criminal investigation, government prosecutors may choose to intervene to seek a stay of all civil proceedings. Courts have discretion to stay civil proceedings and will balance multiple factors on a "case-by-case determination, with the basic goal being to avoid prejudice."[68] These factors include: (1) the private interests of the plaintiff in proceeding expeditiously with the civil litigation as balanced against the prejudice to the plaintiff from a delay; (2) the private interests of and burden on the defendant(s); (3) the interests of the courts; (4) the interests of persons not parties to the civil litigation; and (5) the public interest.[69]

A stay is more likely to be granted when requested by the DOJ to protect an ongoing investigation because case law has recognized a strong public interest in criminal prosecution.[70] In October 2013, for example, a Nevada state court granted a requested six-month extension on a stay of a civil case against a former shareholder of a major casino and gaming company based on the DOJ's

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[66] 15 U.S.C. § 78u-4(b).

[67] *See United States v. Stringer*, 521 F.3d 1189 (9th Cir. 2008) (describing standardized SEC admonition form that "warned that the SEC would likely turn over to the USAO evidence it collected at the depositions").

[68] *Volmar Distrib., Inc. v. The New York Post Co.*, 152 F.R.D. 36, 39 (S.D.N.Y. 1993).

[69] *Keating v. Office of Thrift Supervision*, 45 F.3d 322, 324-25 (9th Cir. 1995); *SEC v. Jones*, 2005 WL 2837462 (S.D.N.Y. Oct. 28, 2005); *In re Worldcom Inc. Sec. Litig.*, 2002 WL 31729501, at *3-4 (S.D.N.Y. Dec. 5, 2002) (collecting cases).

[70] *Campbell v. Eastland*, 307 F.2d 478, 487 (5th. Cir. 1962); *In re Ivan F. Boesky Sec. Litig.*, 128 F.R.D. 47, 49 (S.D.N.Y. 1989).

sealed evidence filed in support of its claim that a criminal bribery investigation against the shareholder could be compromised by parallel civil discovery.[71] Similarly, federal courts hearing civil cases have granted stays to preserve related criminal investigations.[72] However, some recent district court opinions from the Second Circuit have disapproved of DOJ-filed stay motions when the only parallel civil proceeding is an SEC action with which the DOJ has coordinated.[73] For example, in November 2013, a federal court rejected a motion by the DOJ to stay a parallel SEC civil case against an SAC Capital Advisors portfolio manager because the judge was not persuaded that the government had provided sufficient evidence of prejudice to its criminal investigation.[74]

An additional risk of parallel criminal investigation bears note. A corporation can potentially risk adverse consequences where an implicated officer or director invokes the Fifth Amendment privilege against self-incrimination in response to discovery in the civil action out of concern for possible consequences in a related criminal investigation. Corporations do not enjoy a Fifth Amendment privilege against self-incrimination, but individuals do.[75] An individual may assert the privilege in any proceeding where "a responsive answer to the question or an explanation of why it cannot be answered might be dangerous because injurious disclosure could result."[76] A number of states do not allow a fact-finder to draw a negative inference regarding an individual's invocation of the privilege in a civil proceeding.[77] However, federal courts do allow a negative inference to be made against the individual:[78] the fact-finder can infer from the witness's refusal to testify that the witness's answers would have been adverse to the witness's interest.[79] Several federal circuits have found that an adverse inference for civil litigation purposes can also potentially be triggered against a corporation when one of its executives or employees, even if a non-party to the litigation, invokes the privilege.[80] The Second Circuit in *LiButti* set forth four non-exclusive factors to determine whether an adverse inference can be drawn against a party (*e.g.* a corporation) when a non-party (*e.g.* an officer or director) invokes the privilege: (1) the nature of the relevant relationships; (2) the degree of control the corporation has over the non-party; (3) the compatibility of the interests of the corporation and non-party witness in the outcome of the litigation; and (4) the role of the non-party witness in the litigation (*i.e.* whether the non-party is a key figure in the facts underlying the matter).[81] In a recent case, *S.E.C. v. Monterosso*, the federal district court held that an adverse inference could be drawn against the corporation when its chief financial officer invoked the Fifth Amendment privilege on the grounds that "the individual defendants were acting in the scope of their employment when they engaged in the conduct they refused to testify about."[82] A corporation may therefore face additional disadvantages in civil litigation arising from the potential for parallel criminal action that threatens to implicate its executives or employees.

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[71] *Wynn Resorts, Ltd. v. Kazuo Okada*, C.A. No. A-12-656710-B (Oct. 31, 2013).

[72] *S.E.C. v. Nicholas*, 569 F Supp. 2d 1065, 1067 (C.D. Cal. 2008).

[73] *S.E.C. v. Cioffi*, 2008 WL 4693320, at *1 (E.D.N.Y. Oct. 23, 2008) ("Courts are justifiably skeptical of blanket claims of prejudice by the government where – as here – the government is responsible for the simultaneous proceedings in the first place."); *S.E.C. v. Saad*, 229 F.R.D. 90, 91 (S.D.N.Y. 2005) ("[I]t is stranger still that the U.S. Attorney's Office, having closely coordinated with the SEC in bringing simultaneous civil and criminal actions against some hapless defendant, should then wish to be relieved of the consequences that will flow if the two actions proceed simultaneously."). *But see S.E.C. v. Nicholas*, 565 F. Supp. 2d. 1065, 1071 (C.D. Cal. 2008) ("The SEC was obligated to pursue civil violations expeditiously, independent of the criminal charges….").

[74] *S.E.C. v. CR Intrinsic Investors, LLC*, 1:12-cv-08466-VM (Nov. 15, 2013).

[75] *Curcio v. United States*, 354 U.S. 118, 122 (1957) ("It is settled that a corporation is not protected by the constitutional privilege against self-incrimination.").

[76] *Ohio v. Reiner*, 532 U.S. 17, 21 (2001).

[77] *See, e.g.*, Cal. Evid. Code § 913(a) (California); Del. R. Evid. § 512 (Delaware); N.J. R. Evid. 532 (New Jersey); Or. Rev. Stat. § 40.290 (Oregon); Vt. R. Evid. 512 (Vermont).

[78] *Baxter v. Palmigiano*, 425 U.S. 308, 317 (1976) (allowing adverse inferences to be made in civil case).

[79] *See, e.g., Brink's Inc. v. City of New York*, 717 F.2d 700, 707 (2d Cir. 1983).

[80] *See, e.g., LiButti v. United States*, 107 F.3d 110, 121-22 (2d Cir. 1997); *Rosebud Sioux Tribe v. A&P Steel, Inc.*, 733 F.2d 509, 521-22 (8th Cir. 1984); *RAD Servs., Inc.*, 808 F.2d 271, 275 (3d Cir. 1986).

[81] *LiButti v. United States*, 107 F.3d 110, 121-22 (2d Cir. 1997).

[82] *S.E.C. v. Monterosso*, 746 F.Supp.2d. 1253, 1263 (S.D. Fla. 2010).

CONCLUSION

For the reasons discussed above, corporations under investigation by the DOJ or SEC must quickly and carefully implement a strategy that accommodates the mutual impact between government investigations and related private plaintiff suits. Actions taken in ongoing criminal or civil investigations, including DOJ and SEC investigations, can affect the viability of a corporation's defense strategy in related shareholder litigation. Care should therefore be exercised to avoid compromising the corporation's privileges and protections, or creating additional civil liability because of precipitous actions taken in response to the investigation. Further, corporations should remain sensitive to the importance of ensuring independent leadership by disinterested outside directors in addressing and remediating any corporate misconduct that may have occurred, and properly handling the corporation's disclosures to the government and the market. Finally, consideration should also be given to the potential effects that civil litigation strategies can have on the outcome of government investigations as well, including the government's perception of a corporation's acceptance of responsibility, the additional "prosecutor" phenomenon, and the possibility that the government may seek to take action to prevent what it perceives as civil litigation's potential to jeopardize the development of a criminal case. The corporation should also factor in the possibility of adverse inferences resulting from employees' civil litigation strategies.

Without a broad understanding of the interplay between the government investigation and related civil proceedings, a corporation may not see the potential for certain decisions that might normally seem intuitive and appropriate in one proceeding as having highly adverse consequences in another. A comprehensive understanding of where the traps and pitfalls may lie, however, will help to ensure that a corporation's efforts to meaningfully cooperate with law enforcement priorities do not end up compromising its legitimate defense in the civil arena. ■