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A Guide to Defense Counsel Selection in Securities Class Actions

By Doug Greene

Selection of the right defense counsel is the first key strategic step in the case. Yet most companies have never faced a securities class action and they make the decision without the advice of a disinterested lawyer or securities litigation repeat player such as a D&O insurer or broker. And, to make matters worse, they are pelted with pitches from dozens of law firms all claiming they're the best.

Most mistakes in securities litigation are made before the first pleading is filed: selection of counsel that doesn't have the right expertise, experience, or economics for the particular case, or is hard to work with. This paper discusses the steps every company should take, and the issues they should consider, in choosing the right defense counsel for them and their particular case.

10 Essential Steps to Selecting the Right Defense Counsel for Your Case

If you or your company have been named in a securities class action, there are many complex issues to consider. Fortunately, the process set out by the Reform Act gives you some breathing room before most decisions need to be made – including the all-important decision of who you will select to defend your case. As an initial matter, the Reform Act provides for a 90-day lead plaintiff selection process, and most defense obligations don't commence until after this process has concluded. As a result, you have time to make an informed decision regarding defense counsel.

Securities litigation is a specialty field, and it can be nearly impossible to differentiate among the claims of expertise and experience made by the herd of lawyers that descends upon a company after a suit is filed. And it's a serious error, especially for midsize and smaller companies, to use a brand-name law firm as a proxy for quality and fit.

Because of the pivotal strategic significance of defense counsel selection, it is imperative that securities litigation defendants go through a counsel selection process. There are 10 key steps to take.

1

Conduct an interview process.

2

Ask your D&O broker and insurer for recommendations about which firms to interview. They are securities litigation repeat players and will know who's who among defense lawyers.

3

Involve your board in the counsel selection process.

4

Look at firms beyond your regular outside firms, which often aren't the right firms to defend the litigation and are never the right firms to exclusively evaluate whether they are.

5

Securities litigation is a national practice, so consider firms from around the country. There is a relatively small national bar of full-time securities plaintiffs' lawyers and securities defense lawyers.

6

Search for value: the right combination of expertise and efficiency.

7

Consider firms beyond those about which people say "no one ever got fired for using _______." In reality, you might get fired for using a firm that charges a fortune and doesn't do a good job.

8

Select three to five firms of different types and with different strategies to interview.

9

Conduct interviews in person at your office. The law firms will gladly travel to meet you at their own expense, and it's important to get to know the lawyers in person and in your environment.

10

Ask the candidates for references, and call them. Also, call friends and acquaintances who have been involved in securities litigation. They have good insights, and often have strong views.

In the remaining sections of this chapter, we explain this advice in detail and identify traps for the unwary.

The Economics of Securities Litigation Matters

One emerging risk to companies is that ever-increasing securities defense fees no longer match the economics of most cases and are quickly outpacing D&O policy limits. In the past, securities class actions were initiated by an oligopoly of larger plaintiffs' firms with significant resources and mostly institutional clients that tended to bring larger cases against larger companies. But as we noted earlier, smaller plaintiffs' firms with retail investor clients recently have been initiating more cases, primarily against smaller companies. Indeed, in recent years, approximately half of all securities class actions were filed against companies with $1 billion or less in market capitalization.

Yet at the same time, the amounts that most defense firms charge to defend litigation have increased exponentially. This creates the danger that a company's D&O policy will be insufficient to cover the fees for a vigorous defense and the price to resolve the case. Indeed, inadequate policy proceeds due to skyrocketing defense costs are by far the biggest risk directors and officers face from securities litigation.

To address the problems caused by their economic structures, many defense firms try to reduce the cost of defending cases by cutting corners by forgoing important tasks, delegating important roles in the case to junior attorneys or settling prematurely for an unnecessarily high amount. These types of "fixes" carry with them a set of different, and worse, problems.

It obviously makes no sense for a firm to charge $15 million to defend a case that can settle for $15 million. It is even worse for that same firm to attempt to defend the case for $7 million instead of $15 million by cutting corners – whether by understaffing, overdelegating to junior lawyers, or avoiding important tasks.

It is worse still for a firm to charge $2 million through the motion-to-dismiss briefing and then, if they lose, to settle for more than $15 million just because they can't defend the case economically past that point. And it is a strategic and ethical minefield for a firm to charge $15 million and then settle for a larger amount than necessary so that the fees appear to be in line with the size of the case.

Obviously, companies and their directors and officers should not be subjected to these hazards – which are created not by the securities class action itself, but by law firm economics.

The vast majority of securities class actions – if handled in the right way by the right defense counsel – can be defended and either won or settled, within D&O insurance policy limits, leaving no residual liability for either the company or its directors and officers. With the upfront commitment of the time and effort to select the right counsel at the beginning of the litigation, securities litigation defendants can put these cases on the right track.

Outside Directors Should Be Involved in the Counsel Selection Process

Although much of the recent discussion about securities litigation has revolved around meritless merger litigation, securities class actions and associated shareholder derivative actions have always posed greater risk than merger actions. A securities class action alleges that a company and its representatives made false or misleading statements that artificially inflated the stock price. Directors are virtually always included in Section 11 cases, which challenge statements in registered offerings, and increasingly they are named in Section 10(b) actions, which can challenge any public corporate statement. Directors often are named in tag-along shareholder derivative actions as well, which allege that the directors failed to properly oversee the company's public disclosures.

Often, because the initial complaint is merely a placeholder, it is difficult to know whether a securities case will pose a personal risk to directors. Only after the court selects the lead plaintiff and lead counsel will the plaintiffs' attorneys draft more substantial allegations and add defendants through an amended complaint.

But regardless of any personal risk, directors have a duty to oversee the significant potential liability the company faces. For these reasons, directors should treat each one of these cases as if they are personally named.

An Interview Process is Essential in All Cases, No Exceptions

When a public company purchases a significant good or service, it typically seeks competitive proposals. From coffee machines to architects, companies invite multiple vendors to bid, evaluate their proposals, and choose one based on a combination of quality and cost. Yet companies named in a securities class action frequently fail to engage in a competitive interview process for their defense counsel, and instead simply retain litigators at the firm they use for their corporate work.

But all companies should take their time in making a decision on counsel to defend a securities class action. Unlike many other types of litigation, it is often prudent for a company to look beyond its normal outside counsel for attorneys who specialize in this kind of work. Not only do specialists have enormous advantages in litigating these types of suits but, depending on the nature of the allegations, there may also be significant conflicts of interest that would prevent outside counsel from providing the best defense. We discuss these potential conflict of interest issues further in next section.

To be sure, it is difficult for company management to tell their outside corporate lawyers that they are going to consider hiring another firm to defend a significant litigation matter. The corporate lawyers are trusted advisors – often former colleagues of the in-house counsel – and have usually made sacrifices for the client that make the corporate lawyers expect to be repaid through engagement to defend whatever litigation might arise. A big litigation matter is what makes all of the miscellaneous loss-leader work worth it. "You owe me" is the unspoken – and sometimes spoken – message.

Corporate lawyers also make the pitch that it will be more efficient for their litigation colleagues to defend the litigation since the corporate lawyers know the facts and can work with the firm's litigators more efficiently. Meanwhile, they tell the client that there is no conflict. Even if their work on the company's disclosures is at issue, they assure the company that they will all be on the same side in defending the disclosures, and if they have to be witnesses, the lawyer as witness rules will allow them to work around the issue.

All of these assertions are flawed. It is always – without exception – in the defendant's interests to take a day to interview several defense firms of different types and perspectives. And it is never – without exception – in their interests to simply hand the case off to the litigators of the company's corporate firm without a competitive interview process.

Even if the defendants hire the company's corporate firm at the end of the interview process, they will have gained tens of thousands of dollars of free legal advice, including important perspectives about potential problems with corporate counsel's defense of the case.

An interview process gives defendants the opportunity to hear from several experienced securities litigators who will offer a range of analyses and strategies on how best to defend the case. It also allows defendants to evaluate professional credentials and personal compatibility, which are both important criteria. It is difficult, if not impossible, for a company to evaluate how their corporate counsel's litigators stack up against other litigators in this specialized and national practice area without first hearing from some other firms.

If properly structured, an interview process is highly substantive. The firms that fare best in a new-case interview typically prepare thorough discussions of the issues, and come prepared to analyze the case in great detail. And the best ones look beyond the issues in the initial complaint to the issues that might emerge in the amended complaint, analyzing the full range of the company's disclosures, forecasting future disclosure and scienter allegations, and evaluating the defenses that will remain even after allegations are added.

An interview process also helps the company achieve a better deal on billing rates, staffing, and alternative fee arrangements. Without an interview process, a law firm is much more likely to charge rack rates and do its work in the way it sees fit – which defendants are rarely in a position to challenge without having done some comparison shopping.

Even though securities class action defense costs are covered by D&O insurance, price matters in defense counsel selection. It is a mistake to treat D&O insurance proceeds as "free money." Without appropriate cost control, defendants run the risk of not having enough insurance proceeds to defend and resolve the case. Appropriate cost control can help keep the litigation from resulting in a difficult or expensive D&O insurance renewal, and can allow the company to save money if the fees are less than the deductible.

An interview process also helps get the defendants off to a better start with its D&O insurers. In addition to appreciating the cost control that an interview process yields, insurers appreciate the defendants making a thoughtful decision on defense counsel, including vetting the potential problems with use of the company's corporate firm. Asking insurers and brokers to help identify defense counsel to interview may not only yield helpful suggestions, but also make it easier to develop a relationship of strategic trust with the insurers – which will then make it easier to obtain consent to settle early if appropriate and, if not, to defend the case through summary judgment or to trial.

Perhaps most importantly, an interview process results in a better relationship between the defendants and their lawyers. Most securities class action defendants are troubled by being sued, and need lawyers they can trust to walk them through the process. Interviewing is the best way to find the lawyers who have the right combination of relevant characteristics – including skills, strategy, and bedside manner – that will best fit the defendants' needs.

Potential Problems With Using Corporate Counsel

Ethical and practical conflicts that lurk beneath the surface can make it unwise for a company to hire its regular outside firm for securities class action defense – and these conflicts need to be examined more closely by companies, their insurance carriers, and the counsel seeking to represent them.

It is a dilemma that all securities counsel faces at one time or another – when should they turn down representation of a firm client in a securities lawsuit? The North Star of the analysis is a basic principle: Attorneys should not represent a client when they have a conflict that could compromise the client's defense. In the context of securities litigation defense, a conflict can arise when it is in the client's interest to rely on the defense firm's corporate work as a defense against allegations of falsity or scienter, or to establish a due diligence defense. For the client, it is a question that boils down to whether the same firm that provided disclosure or stock-trading advice can make an objective decision about whether to disclose that advice in order to assert these defenses.

While it is companies that make disclosures, lawyers play a prominent role in many disclosures by drafting or editing them, advising the company about their adequacy, and weighing in on decisions not to disclose certain information. This is more true of some disclosures than others. Public offering materials, for example, are likely to be largely drafted by the attorneys, who will weigh in on every important disclosure decision.

Lawyers also advise on matters that bear on scienter – primarily the presence or absence of material nonpublic information in connection with establishment of 10b5-1 plans and periodic stock sales – and on stock offerings. Even if lawyers have not technically provided legal advice or representation on these matters, directors and officers often rely on their regular counsel to object to potential misrepresentations or ill-advised stock sales about which they had notice, and potential conflicts may arise with corporate counsel in the course of a securities class action as a result.

A Section 10(b) claim involves litigation of whether the defendants (1) made a false statement or failed to disclose a fact that made what they said misleading in context; and (2) made any such false or misleading statements with intent to defraud (i.e., scienter). Corporate counsel is very often an important fact witness for the defendants on both of these issues.

For example, in a great many cases, corporate counsel has:

- Drafted the disclosures that plaintiffs challenge, so that the answer to the question "Why did you say that?" is "Our lawyers wrote it for us."
- Advised that omitted information wasn't required to be disclosed, so that the answer to the question "Why didn't you disclose that?" is "Our lawyers told us we didn't have to."
- Reviewed disclosures without questioning anything, or not questioning the challenged portion.
- Drafted the risk factors that are the potential basis of the protection of the Reform Act's safe harbor for forward-looking statements.

- Not updated the risk factors that are the potential basis of safe harbor protection.
- Advised on the ability of directors and officers to enter into 10b5-1 plans and when to do so, and on the ability of directors and officers to sell stock at certain times, given the presence or absence of material nonpublic information.
- Advised on individual stock purchases.

The fact that the lawyer has given or not given such advice can win the case for the defendants. For any case turning on a statement of opinion, for example, the lawyer's advice that the opinion had a reasonable basis virtually guarantees that the defendants won't be liable. Likewise, a lawyer's drafting, revising, or advising on disclosures virtually guarantees that the defendants didn't make the misrepresentation with scienter, and a lawyer's advice on the timing of entering into 10b5-1 plans or selling stock makes the sales benign for scienter purposes.

To the defendants, it doesn't matter whether the lawyer was right or wrong. As long as the advice wasn't so obviously wrong that the client could not have followed it in good faith, the lawyer's advice protects the defendants. But to the lawyer, it matters a great deal for purposes of professional reputation and liability. Deepening the conflict is the specter of the law firm defending its advice on the basis that the client didn't tell them everything. The interests of the lawyer and defendant client thus can significantly diverge.

The possibility that this information may be privileged doesn't change this analysis. Of course, the privilege belongs to the client, who can decide whether to use the information in his or her defense. But with corporate counsel's litigation colleagues guiding the development of the facts, privileged information is rarely analyzed, much less discussed with the client.

The reality is that most privileged information isn't truly sensitive to the client, but instead reflects a client seeking advice – and seeking the liability protection it provides. But from the lawyer's perspective, there can be much to protect. Privileged communications may reflect poor legal advice, and internal files may contain candid discussions about the client and the client's issues that, if produced, would result in embarrassment to the firm and possible termination.

Let's analyze the situation with a simple hypothetical. A securities class action against Acme Corporation challenges a statement in Acme's 10-K. Acme's regular outside corporate counsel provided advice to the company about the challenged disclosure, including advice that certain omitted information that allegedly made it misleading did not need to be disclosed. As evidence of scienter, the lawsuit cites Acme's officers' sales of company stock pursuant to 10b5-1 plans established during the alleged class period. Corporate counsel advised that the officers had no material nonpublic information when they established the plans.

Acme and the individual defendants will have an interest in defending themselves by asserting that they relied on the law firm's advice, both as to the disclosure decision and the stock sales. At first blush, it may seem that the positions of Acme and its law firm are the same. Both want to defend the correctness of the disclosures and stock-sale decisions. But their interests are decidedly different:

- Even if the law firm's advice was wrong, the defendants may be able to avoid liability through disclosing and relying on the advice, as long as the defendants' reliance was reasonable and genuine.
- Acme's law firm has a strong interest in preventing the disclosure of incorrect legal advice that could not only prove embarrassing, but also expose the firm to liability. And even if their advice is defensible, lawyers do not like to have their legal work, including their internal law firm communications, produced in discovery – and potentially dissected by competing firms. Regardless of the merits, lawyers have a natural aversion to testifying or making themselves the focus of litigation.

This all means that defense firms that also serve as corporate counsel have enormous incentives to avoid having their clients introduce evidence about their legal work, even if that evidence is plainly in the clients' interest. These defense firms are motivated, consciously or not, to steer the clients away from a defense based on reliance on legal advice – something that may be easy to do without many questions being asked, because of the general bias against revealing privileged information. While this may not result in substantial prejudice if there are good defenses otherwise, there undoubtedly is prejudice in many cases that is largely invisible to the client (e.g., through higher settlement amounts than would otherwise be necessary, or pressure to settle a case that might otherwise be a good trial candidate).

Perhaps even more importantly, regular corporate counsel's litigation colleagues may fail to assess the case objectively, in part because it implicates the work of their corporate colleagues and in part because of a desire not to ask hard questions that could strain the firm's relationship with the client.

Sometimes the problem arises from a deliberate attempt by the lawyers to protect a particular person who may have made an error leading to the litigation, such as the general counsel (often a former colleague), the CFO, or the CEO – all of whom are important to the client relationship. But it might also be due to a more generalized alliance with the people with whom the law firm works regularly. It's hard for a lawyer to scrutinize someone who will be in the firm's luxury box at the baseball game that night, much less report a serious problem with him or her to the board.

Yet the defendants, including the board of the corporate client, need candid advice about the litigation in order to protect their interests. For example, some problematic cases should be settled early, before the insurance limits are significantly eroded by defense costs and documents are produced that will make the case even more difficult and possibly even spawn other litigation or government investigations. Defendants and corporate boards need to know this.

Corporate firms might counter that their litigation colleagues will give sound and independent advice, because they are a separate department and will face no economic or other pressure from the corporate department. But that undermines one of the main reasons corporate lawyers urge that their litigation colleagues be hired – that it is more efficient to use the firm's litigators since they work closely with the corporate lawyers, if not the company itself.

The corporate firm can't have it both ways. Either the litigators are close to the corporate lawyers and the company and suffer from the problems outlined above, or they are independent and their involvement yields little or no benefit in efficiency.

Indeed, it is most likely that the corporate firm's litigators will be hindered by conflict, while nevertheless failing to create greater efficiency. Just because lawyers are in the same firm doesn't mean that they can read each other's minds. They still have to talk to one another, just as litigators from an outside firm would have to do.

Pay Attention to Economics

Perhaps one factor discouraging companies from conducting an interview process is that the prospect of selecting candidates to interview from among the numerous, substantially similar firms that hold themselves out to have securities litigation expertise may seem daunting. This section discusses why companies should avoid assuming the very highest-priced lawyers are the "safest" choice. In many cases, that's not so.

Companies and their directors and officers understandably feel threatened by securities class actions:

- Plaintiffs asserting 10b-5 claims allege that the defendants lied on purpose, and claim theoretical damages in the hundreds of millions or billions of dollars in the lion's share of cases.
- Plaintiffs asserting Section 11 claims have relaxed standards of pleading and proof – the company's liability is strict, and individuals have the burden of showing their due diligence.
- Section 11 damages are typically lower than 10b-5 damages, but they are still substantial.

Not surprisingly, many defense firms exaggerate this threat so that the obvious and necessary recourse seems to be to hire their firm. In turn, in-house lawyers often turn reflexively to firms with the very biggest names. This is especially so if such a "safe" firm is their regular outside firm.

Busy CEOs and CFOs, the typical individual defendants, rely on their in-house lawyers' recommendation of which firm or firms to hire or interview. Boards often defer to management's hiring process and recommendation or decision, even though board members often will become defendants themselves in a related shareholder derivative action shortly after the securities class action is filed.

In reality, however, very few securities class actions pose a real threat to the company or its directors and officers. Most are brought by a small group of plaintiffs' firms that have a playbook that experienced defense counsel know well.

There are few surprises in the vast majority of cases. Indeed, at the outset of a securities class action, most good securities defense lawyers and D&O insurance professionals can accurately estimate the odds of prevailing on a motion to dismiss and, if the case is not dismissed, the value of a settlement.

Securities class actions follow a highly predictable course. The first step, of course, is a motion to dismiss. Because of the high pleading standards imposed by the Reform Act, the rate of dismissal of 10b-5 cases is high. Of cases that are not dismissed, nearly all are settled short of a trial verdict. And settlement amounts are generally relatively modest and almost always covered by D&O insurance.

To illustrate the way that some firms tend to over- or under-litigate securities actions, let's use a hypothetical case. Acme and its CEO and CFO are sued in a securities class action. Acme has $25 million in D&O insurance, which is an appropriate amount based on Acme's market capitalization, risk profile, and other company and industry considerations. Acme hires Dewey Cheatham & Howe to defend the litigation. Defense counsel's hourly billing rates range from $1,500 for the senior partner to $700 for a new associate. There are two partners and six associates at various levels assigned to the case.

At the outset of the case, Acme's economist conducts a preliminary "plaintiffs' style" damages analysis, and estimates that plaintiffs will assert damages of around $500 million. Based on this estimate of asserted damages and analysis of various other factors, Acme's economist, D&O insurer, and defense counsel suggest that the case should settle in the range of $10 million to $15 million.

Acme makes a motion to dismiss the securities class action – and loses. Acme's defense counsel's fees through the motion to dismiss total $1.5 million.

Acme's D&O insurer asks defense counsel for a budget through completion of discovery and summary judgment – i.e., not including trial costs. Defense counsel gives the insurer an estimate of $10 million (and, in most matters, the defense budget understates what the actual defense costs will be).

Around the same time, an Acme shareholder files a tag-along shareholder derivative action against Acme's directors and officers. Acme intends to move to dismiss the shareholder derivative action. Depending on the outcome of the motion, defense counsel gives a budget estimate of $1 million to $5 million up to, but not including, trial.

Let's pause here. At this point, at least $12.5 million of Acme's $25 million of D&O insurance will be depleted for work up to, but not including, trials in the two matters: $1.5 million incurred, plus $11 million estimated. That amount could grow to $16.5 million if the derivative action survives a motion to dismiss. And the actual cost could be even higher if the defense firm's estimates are indeed low.

So let's say a better estimate of total defense costs for the securities and derivative actions, not including trials, would be $20 million. Based on that estimate, Acme would have as much as $12.5 million and as little as $5 million with which to settle the litigation if it were to litigate through summary judgment – which is normal in complex commercial cases because it helps the parties reach a settlement that reflects the actual merits of the litigation. And if the case did not settle at that point, there would not be enough insurance proceeds left to take the case to trial.

What are Acme's options?

- First, it could proceed to defend the litigation through summary judgment. However, absent a denial of plaintiffs' motion for class certification or dismissal on summary judgment, at most there would remain just enough to settle within insurance limits, and if the defense firm has underestimated defense costs, there probably would not be sufficient proceeds left for settlement – which means that Acme itself would need to write a check.
- Second, Acme could try to settle the case at this point, before incurring further defense costs. This would allow for a settlement within policy limits. However, early settlements tend to be more expensive than later settlements – meaning they overpay the plaintiffs. And Acme and its directors and officers feel they did nothing wrong, and would prefer to litigate the case further and try to obtain dismissal at class certification or summary judgment – and perhaps even consider taking the case to trial. (Acme has tried several large commercial and IP cases over the years, and likes to take cases to trial if they can't be settled reasonably.)

Thus, Acme has two options: It can defend the case past its insurance limits, or it can settle early and probably pay more than the merits say it should. To avoid this dilemma, some firms sometimes employ a third alternative: They under-litigate cases, cutting corners to make their economics fit matters that don't justify the billing they would generate based on their "normal" rates and staffing practices. The result, of course, is a diminished defense.

The Importance of Looking at Securities Litigation Specialists From Around the Country

Litigation venues are regional. We have state courts and federal courts organized by states and areas within states. Since lawyers need to go to the courthouse to file pleadings, attend court hearings, and meet with clients in that location, the lead lawyer handling a case should live where the judge and clients live. Right?

Not anymore.

Although the attitude that a case needs a lead local lawyer persists, it's no longer how litigation works. We don't file pleadings at the courthouse. We file them on the internet from anywhere. There are just a handful of in-person court hearings in most cases. And the reality is that most clients don't want their lawyers hanging around in person at their offices – email, phone calls, and Skype suffice. Even most document collection can be done electronically and remotely. And with increasingly strict deposition limits, and witnesses located around the country and the world, depositions often don't require much time in the forum city, either.

In a typical Reform Act case where discovery is stayed through the motion-to-dismiss process, the amount of time a lawyer needs to spend in the forum city is especially modest. If a case is dismissed on a motion to dismiss, the case activities in the forum city typically amount only to (1) a visit to the clients' offices to learn the facts necessary to assess the case and prepare the motion to dismiss, and (2) the motion-to-dismiss argument, if there is one.

Indeed, assuming that a typical securities case requires a total of 1,000 hours of lawyer time through an initial motion to dismiss, fewer than 50 of those hours – one-half of one percent – need to be spent in the forum city. The other 99.5 percent can be spent anywhere.

Discovery doesn't change these percentages much. Assume that it takes another 10,000 hours of attorney time to litigate a case through a summary judgment motion, or 11,000 total hours. Four lawyers/paralegals spending four weeks in the forum city for document collection and depositions (a generous allotment) yields only another 640 hours. So in this hypothetical scenario, only 0.63 percent of the defense of the case requires a lawyer to be in the forum city. The other 99.37 percent of the work can be done anywhere. Nor does the cost of travel move the economic needle. The best law firms put the right team together based on skills and economics, and any travel cost is minuscule.

Of course, there are some purposes for which local counsel is necessary, or at least ideal – someone who knows the local rules, is familiar with the local judges, and is admitted in the forum state. But if the lawyers' roles are clearly defined, the benefits of relying on local counsel for a limited number of tasks doesn't present any economic or strategic issue, either.

Depending on the circumstances, a local lawyer in a litigation boutique that was formed by former large-firm lawyers with strong local connections or a lawyer from a strong regional firm can serve as effective local counsel. In either instance, bills from the local firms would typically be de minimis. In some cases, the local firm can and should play a larger role but, whatever the type of firm and its role, the lead and local lawyers can develop the right staffing for the case and work together essentially as one firm – if they want to.

All of these considerations show that securities litigation defense can and should be a nationwide practice. We need look no further than the other side of the "v" for a good example. Our adversaries in the plaintiffs' bar have long litigated cases around the country, often teaming up with local lawyers from different firms. Like securities defense, plaintiffs' securities work requires a full-time focus that has led to a relatively small number of firms being qualified. The qualified firms litigate cases around the country, not just in their hometowns or even where their firms have lawyers.

The bottom line of all this is simply common sense. Within the qualified group of lawyers, a company should look for value – the right mix of experience, expertise, efficiency, and cost – as it does with any significant corporate expenditure.

Considerations Regarding Board Representation

There's a final question that a company must answer when it is defending both a securities class action case and related derivative litigation: Which lawyers should represent the company and the individual defendants in derivative litigation?

Because a derivative litigation claim belongs to the corporation, it puts the corporation in an odd spot. A shareholder, as one of the corporation's owners (usually a really, really small owner, but an owner nevertheless), is trying to force the company to bring a claim against the people who run the company. The law says, however, that those people – the directors – get to decide whether the company should sue someone, including themselves, unless a shareholder can show that they couldn't make a disinterested and independent decision.

Thus, to bring a derivative action, a shareholder must allege that it would have been futile to demand that the board take action, and defendants will typically challenge the lawsuit with a motion to dismiss for failure to make a demand ("demand motion") on the basis that the demand-futility allegations aren't sufficiently probative or particularized.

It is often said that the interests of the company and the defendants are aligned through the demand motion, because they all have an interest in making sure that the shareholder follows proper governance procedures – namely, making a pre-suit demand on the board. But this sort of statement prejudges the demand-futility allegations; it assumes that the allegations of futility are insufficient.

In Delaware and states that follow its demand law, proper corporate governance procedures require a shareholder either to make a demand or to plead demand-futility. Only if and when the court rules that demand was required can we truly say that the interests of the company and the defendants on the demand issue were aligned.

However, we don't interpret this to mean that legal ethics require the company to be separately represented from the inception of a derivative action in all cases; the shared-interest view is arguable. So if there are good practical reasons for joint representation from inception and it causes no harm, so be it.

There's also a compelling strategic reason to separate the representation from the beginning of the case. A demand motion asks the court to allow the defendants to be the judge – to require the plaintiff to ask the directors to evaluate and bring claims against themselves and senior officers. Thus, the company must overcome a judge's skepticism that such an evaluation presents a "fox guarding the chicken coop" problem. This is far easier to do if the company is separately represented and makes the demand motion.

It is true that courts frequently grant demand motions made during joint representation of the company and the defendants. But it is also true that joint representation always carries strategic risk, and the more serious the derivative litigation, the more unwise it is to take the risk.

Rather than make judgments in advance about which derivative litigation is serious (warranting a split) and which isn't (which would allow joint representation), it is best practice to split the representation from the outset. Since the representation must be split up if demand is excused, splitting it from the outset imposes relatively little additional cost burden, if there's appropriate coordination.

Representation between and among the defendants has strategic components, in addition to ethical considerations. It can be strategically advantageous for individuals who aren't accused of active wrongdoing to be separately represented from those who are. That typically means officers and outside directors are represented separately in groups. With this division, the court can see that the directors who would evaluate a demand don't have the same lawyers as the people who allegedly engaged in active wrongdoing.

It can sometimes be appropriate to consider even more divisions – for example, splitting the outside directors into audit-committee and non-audit-committee groups where audit-committee oversight is the main oversight allegation. Such divisions may be ethically prudent or necessary later but, for purposes of the demand motion, they often don't add much, if anything, since the demand motion is about the ability of a majority of the full board to consider a demand.

So, a typical case needs at least two lawyers from the outset – one for the company, and another for the individual defendants – though of course, the lawyers should avoid duplication of effort. The type of derivative litigation we're discussing often arises in the context of an underlying legal problem for which the company has lawyers – in a disclosure-related matter for a related securities class action, and in nondisclosure matters for other types of underlying matters (FCPA, antitrust, privacy, etc.).

This begs another question about representation: To what extent should the lawyers defending the underlying matters be involved in the derivative action?

In general, we believe that the lawyers defending the underlying proceedings that created the corporate liability or harm at issue in the derivative case should not defend the derivative case. The reasons are similar to those we've discussed in this chapter in the context of using corporate counsel to defend a securities class action that may involve corporate counsel's advice. There are tricky and hidden conflict issues, and the lawyers can be of greater service to their clients as witnesses.

In derivative litigation, the problem can be even worse. Corporate counsel typically advises on relevant corporate governance issues such as compliance programs, the severity of legal risks that ultimately trigger the derivative litigation, board review of various risks, and preparation or review of board minutes. Some companies are heavily guided in these areas by their corporate counsel, either directly in the boardroom or indirectly through advice to in-house counsel. As we've discussed in this chapter, it very well may be in the interests of the company and the board to be able to testify that they took or didn't take a course of action because of their lawyers' advice.

In derivative cases based on a disclosure problem, another representation issue arises: Who should the securities class action defense counsel represent – the company or the defendants? Securities class action defense counsel take different approaches to dividing derivative litigation representation. Some will represent the company only and have their securities class action individual defendant clients be represented by a different firm. Others represent the individual defendants in the derivative action, and have the company represented by a different firm.

The right approach is a judgment call, but we prefer to have the securities class action defense counsel represent the individual defendants in the derivative action and have another firm represent the company. This approach allows the lawyers in defense mode to fully remain in defense mode – they can defend the lack of merit to the charges of wrongdoing in all proceedings. It also allows the defending lawyers to avoid the tension involved in simultaneously defending individuals in the securities class action and representing the potentially adverse company in the related derivative action.

Conclusion

Securities litigation defense is not one-size-fits-all. It is mission-critical to:

- Interview several firms to find the right lawyer for your case;
- Find a firm that offers the best combination of experience and economics for the case;
- Choose a firm with a lead lawyer whose practice is devoted to securities litigation defense—not a jack-of-all-trades litigator, even a prominent one;
- Evaluate whether a law firm that has done work that may be relevant to the defense is the right firm to defend the litigation; and
- Look for a lawyer who will focus on your honesty through arguments that concentrate on defeating the complaint's falsity allegations.

By carefully and conscientiously following these steps, we're confident that you'll find the firm and lawyer best suited to represent you. Good luck in your search and the defense of your case.

Securities and Governance Litigation Team

Our nationwide team of more than 50 attorneys comprises full-time securities litigators, former Securities and Exchange Commission (SEC) and Department of Justice (DOJ) enforcement trial lawyers, and prominent commercial litigators. Our turnkey team features the full skill set our clients need to win at each stage of the litigation.

We are devoted to winning every case at the earliest possible time. We have an excellent track record of obtaining dismissals prior to any discovery. But if the case survives a motion to dismiss, we don't just throw in the towel: we stand ready to defeat or limit class certification, prevail on summary judgment, and take the case to trial. We are committed to putting "litigation" back in securities and governance litigation.

Of course, we are always attuned to the right time to engage in mediation. Litigating to win – up to and including trial if necessary – best positions our clients to achieve settlements that protect their reputations and resources. Through decades of experience, we have gained the respect of key mediators, plaintiffs' counsel, and D&O insurers and brokers. These relationships are critical to effective mediation of securities and governance cases.

We are also sensitive to the economics of each case. Increasingly, plaintiffs' lawyers are pursuing securities and governance cases against both small and large public companies. We have the ability to scale our team and approach to defend every case both efficiently and effectively. We also are highly experienced in the use of document-processing technology to handle discovery documents and help marshal key facts – which leads to significant efficiencies.

All of this is about protecting people. At the core of every securities or governance case are people accused of doing something wrong – not just directors and officers but also hardworking company employees who find themselves at the center of a securities suit. We focus our defense of each case on these people. From designing legal arguments that defend their honesty, to client-focused economics that maximize their insurance protection, to sensitivity to the stress the litigation may cause them, we work hard to protect people and keep them as comfortable as possible. Protecting people is our top priority in every case.

About the Author

Doug Greene leads BakerHostetler's firmwide Securities and Governance Litigation Team.

Doug is one of the most experienced and successful securities and governance litigators in the United States. He defends and counsels clients in securities class actions, shareholder derivative actions, shareholder challenges to mergers and acquisitions, SEC investigations, and internal investigations.

Doug has focused his practice exclusively on such cases since 1997 and is one of only a handful of full-time practitioners nationwide. He has handled more than 100 securities and corporate governance litigation matters, defending companies of every size and industry — from aerospace giant Boeing, to beverage manufacturer Jones Soda.

Securities and governance litigation can be frustrating — it accuses good people of doing bad things. Doug is devoted to helping clients through it as quickly and comfortably as possible. His defense emphasizes his clients' honesty and good faith, defending the truth of what they said and their intent to do and say the right thing. He doesn't rely on technicalities or gotchas.

Doug also works hard to shape securities law, so that executives can speak publicly and make business decisions without fear of unfair liability. He founded and wrote a pioneering securities and governance litigation blog. He has published dozens of articles. He is a sought-after speaker. He authored U.S. Supreme Court amicus briefs in the Omnicare, Cyan and Quality Systems securities class actions. In Omnicare, Doug contributed to the groundbreaking Supreme Court decision that executives cannot be liable for voicing their honestly held opinions — a position he had long championed.

Clients refer to Doug as an "expert securities litigator." One client said, "Doug Greene came to the [counsel selection] meeting with an in-depth understanding of the specific details of the case and proposed a strategy on how to move forward with a realistic timeline." Another client said, "Doug makes himself available seven days per week, and the first thing he provides is his cell phone number along with a promise to be available at any time, even if it's just to alleviate my worries … I would use [him] again in a heartbeat."

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