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The Disclosure Process Defense to Securities Fraud Claims, Part II: Protecting the Attorney-Client Privilege

This article addresses potential privilege issues that arise from the integral role that in-house counsel typically plays in a company's disclosure process.

Corporate Counsel
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When faced with allegations of securities fraud, a defendant's reliance on a robust and well-functioning disclosure process can be a powerful tool to negate scienter, i.e., fraudulent intent. Part one of this article discussed the theory behind the disclosure process defense as well as key prophylactic steps that can be taken to strengthen the defense for when it is needed. This Part Two addresses potential privilege issues that arise from the integral role that in-house counsel typically plays in a company's disclosure process. First, it distinguishes the superficially similar advice of counsel defense, which requires waiver of the attorney-client privilege. Then it identifies important steps that corporate counsel can take to protect the privilege when a disclosure process defense is asserted.

The Disclosure Process Defense Versus the Advice of Counsel Defense

Both the disclosure process defense and the better-known advice of counsel defense seek to rebut scienter by showing that the defendant relied in good faith on others. However, there are several technical differences between the defenses. The most pertinent concerns the attorney-client privilege.

The advice of counsel defense is based on the substance of legal advice provided by counsel: the defendant argues that there was no fraudulent intent because counsel advised that the disclosure in question was lawful. This puts the legal advice at issue in the litigation—especially whether the defendant is accurately and completely describing the advice—and thereby waives the attorney-client privilege. Courts often invoke the hoary "sword and shield" analogy when allowing discovery into counsel's legal advice.

The disclosure-process defense, in contrast, is based on the process by which a broad range of stakeholders prepared and approved the disclosure in question. In-house counsel is just one of the stakeholders advising the defendant, and the substantive content of the advice provided is not the critical point. What matters is that the final disclosure was vetted through the ordinary course operation of defined procedures and controls, and in particular that the disclosure reflects the collective alignment of participants in the disclosure process after open dialogue and iterative revision.

Protecting the Attorney-Client Privilege

The involvement of in-house counsel in a disclosure process means that careful lines must be drawn to give maximum effect to the disclosure process defense without putting legal advice at issue and transforming it into an advice of counsel defense. To minimize the risk of waiver when a disclosure process defense is asserted, corporate counsel should be mindful of three key principles.

(1) Draft Documentation With an Eye to Discoverability of Non-Privileged Information. The ability to produce documentation of a rigorous disclosure process in discovery is critical to being able to prove up a disclosure process defense. For example, well-crafted minutes of disclosure meetings can illustrate the careful deliberation by many individuals from different corporate functions, including by describing in appropriate detail the matters considered for disclosure, the contributions of particular individuals, the scope and length of the discussion of specific topics, and the information or documents that were considered. By spotlighting non-privileged information, and appropriately and clearly describing privileged

information in a manner that can be easily redacted, documentation from the operation of a disclosure process can be powerful—and non-privileged—evidence against scienter.

(2) Distinguish Between Business Advice and Legal Advice by In-House Counsel. In-house counsel, especially the general counsel, frequently wear multiple hats and provide business advice as well as legal advice. For example, in the context of the disclosure process, the general counsel may be responsible not only for compliance with securities laws and regulations, but also for the corporate communications function. Maintaining clear boundaries between the privileged and non-privileged involvement of counsel can ensure adequate discoverable evidence of the disclosure process's operation. Most obviously, a disclosure process may have a designated "legal review" phase. Additionally, iterative drafts of earnings call scripts, SEC filings, and Q&A talking points—often some of the best evidence for a disclosure process defense—can be distributed for review to all participants in a non-privileged manner, with only comments from counsel that reflect legal advice marked (and withheld) as privileged.

(3) Make Sure the Legal Advice Is Not Put at Issue. The best preparation can go to waste if legal advice provided during the disclosure process is put at issue when the defense is asserted in litigation. This is a facts-and-circumstances inquiry, and some courts have held that too much emphasis on the imprimatur of in-house counsel's approval of the disclosure in question—even if specific legal advice is never referenced—can cause a jury to conclude that legal advice supported the defendant, and thereby put the advice at issue. To minimize this risk, counsel's involvement in the disclosure process should not be highlighted over other participants' roles, and the legal department should generally be listed as merely one of many different corporate functions that participated in the process. To emphasize counsel's role further than identifying the participants may not add enough value to merit the risk when a sufficiently broad range of other corporate functions and personnel participated in the process.

Conclusion

In the current climate of increasingly aggressive government enforcement and private litigation, in-house counsel must be prepared for allegations of securities fraud after nearly any negative corporate event. A robust disclosure process can provide a key defense against such allegations. The steps laid out in this article can help ensure that defense is as strong as possible.

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