LJN
LAW JOURNAL NEWSLETTERS

The Corporate Counselor®

An ALM Publication
Volume 28, Number 12 • March 2014

The Ethical Boundaries of Attorney Whistleblowers

By Lawrence S. Spiegel and Esther E. Bloustein

In recent years, federal legislation has encouraged attorneys to become whistleblowers, first with the rules promulgated by the Securities and Exchange Commission (SEC) under the Sarbanes-Oxley Act of 2002 (SOX) that permit disclosure of client confidential information in certain circumstances and then with the additional whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) that create a financial incentive for disclosure of confidential information.

These whistleblower rules are in tension with the lawyer's duties of confidentiality and avoiding conflicts predicated on attorney self-interest. That's because they allow disclosure of client confidential information more broadly than do applicable ethics rules in many jurisdictions, and incentivize disclosure through monetary compensation to counsel.

In light of this tension fostered by the Dodd-Frank incentive program between counsel's loyalty to the client and a perceived societal need to learn of securities law violations, at least one bar association has opined that attorneys may not ethically

continued on page 9

Supreme Court Hears Challenge to Fraud-on-The-Market Presumption in Securities Fraud Litigation

By Eric Rieder

When the U.S. Supreme Court 25 years ago decided *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), it adopted a legal theory that commentators would describe as revolutionizing securities law in the United States. By accepting the "fraud-on-the-market" theory, the *Basic* Court made it much easier for plaintiffs to get their cases certified as class actions, increasing the potential exposure of corporations and their officers and directors.

This month, the Court will hear argument in a case that seeks to overthrow *Basic's* revolutionary regime. The Court last year agreed to hear the appeal of the corporate defendants in *Haliburton v. Erica P. John Fund;* they directly put to the Court the question of whether *Basic* and the fraud-on-the-market theory it adopted should be overruled.

If the Court ultimately decides to overturn *Basic*, it will likely have a significant impact on securities fraud class actions, depriving plaintiffs' lawyers of a critical doctrinal weapon and giving corporate defendants far greater leverage in settlement negotiations.

Even if it stops short of reversing *Basic*, the Court could still issue an opinion that curtails securities fraud class actions, by giving defendants more ammunition to oppose class certification with evidence that alleged misrepresentations did not affect the stock price.

Many Interested Parties

The high stakes of the case are reflected in the *amicus curiae* briefs filed. In a brief in support of Haliburton's appeal, the Chamber of Commerce of the United States, National Association of Manufacturers and other business groups contend that under *Basic*, "securities fraud plaintiffs get a near free pass to class certification, and the easy certification of plaintiff classes has predictably led to excessive

continued on page 2

In This Issue

Securities Fraud....... 1
Attorney Whistleblowers 1
Teed v. Thomas 3
Data Review 5
Revenue 7

PERIODICALS

Securities Fraud

continued from page 1

securities fraud litigation and the *in terrorem* settlement of insubstantial claims."

By contrast, the United States, through the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), filed a brief supporting the presumption, arguing that parties seeking reversal "identify no good reasons to overrule *Basic's* fraud-on-the market holding," which it contends Congress could have undone through legislation but chose not to. Other *amici* opposing reversal include former SEC Chairmen William H. Donaldson and Arthur Levitt, Jr.

What's at Stake?

Basic is so important because it eased the burden plaintiffs' lawyers had to meet to obtain certification of a class. Among the elements of an investor's securities fraud misrepresentation claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 is reliance — that is, showing that the investor, in purchasing a company's shares, relied on a false statement by the company, its directors or officers.

In seeking to certify a class under Rule 23 of the Federal Rules of Civil Procedure, plaintiffs' counsel would have to show that common, rather than individual, issues predominate in the case. Yet, in showing reliance, each class member arguably could have relied on a different statement by the company, creating a lack of commonality that could defeat class certification.

Thus, the Supreme Court in *Basic* found that "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would" bar a class action.

Eric Rieder is a partner in the New York office of Bryan Cave LLP. A member of this newsletter's Board of Editors, Rieder has broad experience as a litigator in securities and other commercial cases and as an adviser on the duties of directors and officers of both public and private companies. He can be reached at ERieder@bryancave.com.

If proof of individualized reliance were required, individual issues would "overwhelm" common ones.

Basic solved this problem by creating a presumption of reliance — reliance not on any particular statement by a company in its financial statements or SEC filings, but rather, reliance on the fact that all available public information was reflected in the company's stock price. Thus, all investors would be presumed to have relied on the same statement: the market's valuation of a company based on the market's knowledge of all available public information.

Hence, the theory was known as the "fraud-on-the-market" theory.

Fraud-on-the-Market

The underpinnings of this theory were taken from the field of economics, not law. At the time *Basic* was decided, economists were uniting behind the view that the U.S. securities markets were rational, meaning that they took into account all of the information released by a company — its 10Ks and Qs, earnings releases, and the rest of its public statements. From this theory, the Court reasoned that investors were, in effect, making decisions based on the market's assessment of all available public information. Thus, if all investors were relying on the same thing — the market — then a "fraud on the market" was presumptively a fraud on all investors, and the reliance of a class of investors could be viewed as collective reliance, meaning that Rule 23's commonality requirement would be satisfied.

The Court did not apply this approach rigidly. Rather, it said that if the necessary pleadings were made about the efficiency of the market, then the plaintiff would be entitled to a presumption of reliance. The defense would still have the ability to rebut this presumption by showing, for example, that the market for a particular company's stock was not efficient. It did not specifically address at what procedural stage of a litigation this rebuttal could be demonstrated — for example, whether at trial, or earlier, on a pretrial motion for class certification.

continued on page 11

The Corporate Counselor®

EDITOR-IN-CHIEF .... Adam J. Schlagman
EDITORIAL DIRECTOR .... Wendy Kaplan Stavinohav
MARKETING DIRECTOR .... Jeannine Kennedy
GRAPHIC DESIGNER .... Evelyn Fernandez

BOARD OF EDITORS
JONATHAN P. ARMSTRONG ... Duane Morris, London, UK
STEVEN M. BERNSTEIN ..... Fisher & Phillips, LLP, Tampa, FL
VICTOR H. BOYAJIAN .... SNR Denton, Short Hills, NJ
JONATHAN M. COHEN ..... Gilbert LLP, Washington, DC
ELISE DIETERICH .... Kutak Rock LLP, Washington, DC
DAVID M. DOUBILET........ Fasken Martineau DuMoulin, LLP, Toronto
SANDRA FELDMAN .... CT Corporation, New York
WILLIAM L. FLOYD .... McKenna Long & Aldridge LLP, Atlanta
JONATHAN P. FRIEDLAND... Levenfeld Pearlstein LLP, Chicago
AEGIS J. FRUMENTO .... Stern Tannenbaum & Bell LLP, New York
BEVERLY W. GAROFALO .... Jackson Lewis LLP, Hartford, CT
ROBERT J. GIUFFRA, JR. .... Sullivan & Cromwell LLP, New York
HOWARD W. GOLDSTEIN... Fried, Frank, Harris, Shriver & Jacobson, New York
ROBERT B. LAMM .... Attorney, Boca Raton, FL
JOHN H. MATHIAS, JR. ...... Jenner & Block, Chicago
PAUL F. MICKEY JR. .... Steptoe & Johnson LLP, Washington, DC
ELLIS R. MIRSKY .... Mirsky and Associates, PLLC, Tarrytown, NY
REES W. MORRISON .... Altman Weil, Inc., Princeton, NJ
E. FREDRICK PREIS, JR. ..... Breazeale, Sachse & Wilson, L.L.P., New Orleans
TODD PRESNELL .... Bradley Arant Boult Cummings LLP, Nashville, TN
SEAN T. PROSSER .... Morrison & Foerster LLP, San Diego
ROBERT S. REDER .... Milbank, Tweed, Hadley & McCloy LLP, New York
ERIC RIEDER .... Bryan Cave LLP, New York
DAVID B. RITTER .... Neal, Gerber & Eisenberg LLP, Chicago
MICHAEL S. SIRKIN .... Proskauer Rose LLP, New York
LAWRENCE S. SPIEGEL ..... Skadden, Arps, Slate, Meagher & Flom LLP, New York
STEWART M. WELTMAN ..... Fishbein Sedran & Berman, Chicago

The Corporate Counselor® (ISSN 0888-5877) is published by Law Journal Newsletters, a division of ALM. © 2014 ALM Media, LLC. All rights reserved. No reproduction of any portion of this issue is allowed without written permission from the publisher. Telephone: (877)256-2472
Editorial e-mail: wampolsk@alm.com
Circulation e-mail: customercare@alm.com
Reprints: www.almreprints.com

The Corporate Counselor P0000-233
Periodicals Postage Pending at Philadelphia, PA
POSTMASTER: Send address changes to:
ALM
120 Broadway, New York, NY 10271
Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, PA 19103
www.ljnonline.com

Insights. Innovation. Connected.

Acquiring More Than Just Assets

The Impact of Teed v. Thomas & Betts Power Solutions, LLC

By R. Scott Oswald and Tom Harrington

In March 2013, the Seventh Circuit Court of Appeals, in an opinion written by Judge Richard A. Posner, decided the case of *Teed v. Thomas & Betts Power Solutions, LLC*, 711 F.3d 763, 764 (7th Cir. 2013). In a win for employees, the court held that the more plaintiff-friendly federal common law test is appropriate in determining whether an acquiring company assumes the liabilities associated with pending litigation under the Fair Labor Standards Act (FLSA).

The implications of the ruling are clear: Where one company seeks to acquire the assets of another, a simple disclaimer of liability will not be sufficient. Due diligence requires that the successor company closely examine any pending employment-related litigation of the seller and determine how a particular sale implicates the successor liability test under the federal common law.

In addition, and as is relevant to plaintiffs bringing claims under the FLSA, a company cannot escape liability simply by selling off its assets. The violator will pay for its infractions through a reduced sale price and a plaintiff, if successful in proving his cases, will receive compensation for the violations.

An Illustrative Hypothetical

Imagine that a group of employees brings a lawsuit against their employer, 123 Corporation, for failing to properly pay overtime wages as is required under the FLSA. The parties are embroiled in litigation when 123 Corporation takes a turn for the worse.

A competitor, ABC Corp., sees an opportunity. As in-house counsel for ABC Corp., your employer asks you whether the company can purchase 123 Corporation's assets without exposing itself to the potential liability associated with the employees' claims arising under FLSA. "No problem," you think to yourself. "Most states limit successor liability to sales in which a buyer expressly (or implicitly) assumes the selling company's liabilities." You rattle off an e-mail recommending that your employer include language that ABC Corp. will assume 123 Corporation's assets "free and clear of all liabilities" and incorporate a condition that ABC Corp. will not assume any of the liabilities associated with 123's pending FLSA litigation.

Prior to March 2013, your analysis may have been correct. However, in a major win for employees, the United States Court of Appeals for the Seventh Circuit decided the case of *Teed v. Thomas & Betts Power Solutions, LLC*, and reaffirmed that where a liability is based on a violation of a federal statute relating to labor relations or employment — here, in the context of the FLSA — the more plaintiff-friendly common law standard of successor liability is to be applied.

A Primer on Successor Liability in Asset Sales

Before discussing the specifics of the *Teed v. Thomas & Betts Power Solutions, LLC* decision, it is important to understand the basics of successor liability, specifically for asset sales. There are various means by which one company can merge with or acquire the assets of another. In one instance, an acquiring company may seek to purchase a seller's stock or, in another, desire to merge with another company.

Asset sales are a particular type of transaction in which the purchaser picks and chooses those assets and liabilities that it wishes to purchase or assume. Generally speaking, a purchaser is presumed not to acquire the liabilities of the predecessor as a part of the transaction unless doing so is clearly articulated in the purchase arrangement. The rationale for the rule is clear. By allowing an acquiring company to identify only those liabilities that it will assume as part of a deal, the acquiring company can reduce the price offered to the seller. This has, historically, made asset sales an attractive option for an acquiring company insofar as it could limit its exposure to unwanted liabilities by incorporating "disclaiming language" into an agreement.

A Factual Overview of *Teed*

The facts giving rise to the litigation in *Teed* mirror those set forth in the above hypothetical. In 2006, S.R. Bray Corporation (Bray) acquired the stock of JT Packard & Associates (Packard). After the acquisition, Bray allowed Packard to retain the "JT Packard & Associates" name and to continue functioning as Bray's subsidiary and a stand-alone entity.

Approximately two years after the acquisition, 29 of Packard's employees filed a lawsuit against both Packard and Bray, alleging that Packard violated the FLSA by failing to provide overtime pay as is required under the Act. Only months later on May 28, 2008, Bray, Packard's parent company, defaulted on a $60 million loan obtained from the Canadian Imperial Bank of Commerce. Packard, the subsidiary, had guaranteed the loan. In an effort to pay off as much of the $60 million debt as possible, Bray assigned its assets — namely, its stock in Packard — to an affiliate bank which, in turn, auctioned them off.

Thomas & Betts Power Solutions, LLC (Thomas & Betts) was the high bidder and paid approximately $22 million for Packard's assets. As a condition of the transfer, the parties agreed that the transfer would be "free and clear of all Liabilities" that the buyer (Thomas & Betts) had not assumed. Moreover, the agreement specified that Thomas & Betts would not assume any of Packard's potential liabilities arising from the ongoing FLSA litigation with its employees.

continued on page 4

Tom Harrington and **R. Scott Oswald** are principals of The Employment Law Group, P.C., a law firm that represents employees who claim wrongdoing by their employers, including violations of the Fair Labor Standards Act. Based in Washington, DC, the firm takes cases nationwide.

FLSA Actions

continued from page 3

In August 2010, the plaintiffs filed a Motion to Substitute Party under Rule 25 of the Federal Rules of Civil Procedure, seeking to have the District court include Thomas & Betts, the now owner of the business, as a defendant. Applying the federal successor liability doctrine to the FLSA, the District Court found that Thomas & Betts was, indeed, a successor and issued a substitution order.

Thomas & Betts appealed to the Seventh Circuit Court of Appeals, arguing that the District Court's decision to grant Teed's substitution motion (and consequently to allow Thomas & Betts to be named defendants) was contrary to Wisconsin's state law governing successor liability. Specifically, Thomas & Betts argued that because the agreement expressly provided that the company was to be "free and clear of all liabilities" and explicitly disclaimed any liability associated with the pending FLSA litigation, Thomas & Betts — as the acquiring company — should not be held liable for Packard's alleged FLSA violations.

Moreover, Thomas & Betts argued that it was not "an employer" as defined by the FLSA and, as such, it could not be held responsible for the violations of its predecessor, Packer.

The Seventh Circuit Applies The Federal Standard

As discussed above, a purchaser is assumed not to acquire the liabilities of the predecessor as a part of the transaction unless doing so is clearly articulated in the purchase arrangement. The court acknowledged this general rule and also that the agreement in question explicitly sought to exculpate Thomas & Betts from any liability from the pending FLSA litigation. Why, then, did the court find that Thomas & Betts should be held liable for Packer's failure to properly pay its employees for overtime?

First, the Court of Appeals had to decide whether federal or state standards governing successor liability should apply to liabilities based on violations of the FLSA. The court opined, "[T]hat when liability is based on a violation of a federal statute relating to labor relations or employment, a federal common law standard of successor liability is applied that is more favorable to plaintiffs than most state-law standards to which the court might otherwise look." 711 F.3d at 764. The court went on to identify other employment-related acts in which various Courts of Appeals and, indeed, the Supreme Court applied the federal common law standard of successor liability. Such acts include:

- The Labor Management Relations Act in *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964);
- The National Labor Relations Act in *Golden State Bottling Co. v. NLRB*, 414 U.S. 168 (1973);
- Title VII in *Wheeler v. Snyder Buick, Inc.*, 794 F.2d 1228 (7th Cir.1986);
- The Employee Retirement Income Security Act in *Upholsterers' Int'l Union Pension Fund v. Artistic Furniture*, 920 F.2d 1323 (7th Cir.1990);
- The Age Discrimination in Employment Act in *EEOC v. G-K-G, Inc.*, 39 F.3d 740 (7th Cir.1994); and
- The Family Medical Leave Act in *Sullivan v. Dollar Tree Stores, Inc.*, 623 F.3d 770 (9th Cir.2010).

The court concluded that "there is an interest in legal predictability that is served by applying the same standard of successor liability either to all federal statutes that protect employees or to none — and 'none' is not an attractive option at our level of the judiciary, given all the cases we cited earlier." 711 F.3d at 767. Applying this logic, the court dispensed with Thomas & Betts's argument that it is not an "employer" under the Act. Such an argument would be equally true in cases involving other federal acts, and as noted above, courts do impose successor liability in such cases.

The court went on to suggest that "successor liability is appropriate in suits to enforce federal labor or employment laws — even when the successor disclaimed liability when it acquired the assets in question — unless there are good reasons to withhold such liability." 711 F.3d at 766. The court analyzed the following factors in order to determine whether successor liability was appropriate in the case of Thomas & Betts:

- ***Notice***: First the court found that Thomas & Betts "unquestionably" had notice of the pending lawsuit when it purchased Packard.
- ***Pre-Sale Relief***: The court noted that because Packard and Bray would have been unable to provide the relief sought in the lawsuit before the sale (due to their insolvency resulting from the loan default), the predecessors would not have been able to provide the plaintiffs the relief being sought. The court stated that successor liability could be described as a "windfall" to the plaintiffs and chalked this factors up to Thomas & Betts and against successor liability.
- ***Post-Sale Relief***: The court found that because Packard (as a predecessor) would be unable to provide any relief to the plaintiffs after the sale, the plaintiff's claims would be worthless without successor liability. As such, the court found that this factor favored imposing liability upon Thomas & Betts.
- ***Successor's Ability to Provide Relief***: The court found that Thomas & Betts, as a predecessor, was financially able to provide relief.
- ***Continuity of Operations***: The court stated that "nothing really has changed" insofar as the company's post-sale operations were concerned. This supported a finding of successor liability.

The court continued with a lengthy discussion regarding Packard's pre-sale financial situation. The court addressed various arguments and hypotheticals set forth by Thomas & Betts: that had the company been sold piecemeal, there would be no successor liability and, as such, an award to the plaintiffs

continued on page 8

Uncovering the Facts in Litigation And Investigations

Becoming More Proactive in eDiscovery and Review

By Laura Jungels

Over the past decade, the volume of data in litigation and investigations has exponentially increased. As data has become more and more vulnerable to subpoenas and regulators, people have become singularly concerned with making relevance decisions for production. In the process, we have forgotten about focusing on the facts themselves and uncovering the stories within data. The art of fact development — the uncovering of essential data to develop case narratives — has been lost, and it needs to be brought back again.

A common sentiment seems to be that focusing on individual facts just isn't possible due to high volumes or tight deadlines. But not only is it possible — it's essential for building the narrative of your case. There are many benefits to incorporating fact development early on in the review process. It can lead to a more streamlined, efficient review. It can substantially reduce the volume of data you need to analyze. Furthermore, organizing and harnessing the data you uncover can have reverberating effects across current and future reviews.

Rather than waiting until the end of review to consider all the facts, corporate counsel should place a stronger emphasis on conducting fact development in a more proactive manner and on building an early case assessment process that is designed to prioritize data analysis as review unfolds. Instead of waiting for outside counsel to conduct fact development and treating it as an end product, corporate counsel should build fact development into the actual review process itself — and before review even begins.

Laura Jungels is an assistant vice president at Clutch Group, where she manages key client relationships and litigation and investigation matters. Prior to Clutch, Ms. Jungels was with Abbott Laboratories, where she worked closely with eDiscovery vendors and outside counsel to implement new strategies and processes for discovery.

Here's an overview of how best to design and conduct your reviews to get to the facts in a smarter and faster way.

Early Case Assessment: Understanding the Universe Of Data

Not all cases are created equally. It's easy to forget this when you consider the main similarity most major cases share, internal investigation and litigation matter alike: the millions, if not hundreds of millions of documents, that need to be reviewed.

When faced with such large quantities of data, many corporate counsel and outside counsel want to immediately dive into the review and push through as quickly as possible with as many people as possible. While this is understandable, it is not the best way to approach the process. The first step is to take an extra few days — maybe even a week, if your timeline allows for it — to conduct a thorough early case assessment (ECA) with outside parties and to carefully assess and understand the particulars of your case. But you can't fully understand the size and scope of the case, build a project map or manual, or factor in things like your budget, schedule, and legal objectives without first understanding your data. Before anything else, it's important to make sense of the universe of data within the case, at least at a high level — which players are involved, their relationships to one another and to the case, and the type of data you're dealing with.

But where to begin? There's nothing more daunting than dealing with a seemingly unwieldy mass of data. You might even know what you're looking for, but how do you focus on sorting, filtering, and organizing your data in a way that makes sense and is logical and intuitive? This is where technology comes into play.

In an internal FCPA investigation we managed, for example, we were asked to assist a client in identifying whether sales people, distributors, and other employees in foreign countries were bribing government officials to increase sales. We had to identify key people, get a sense of their relationships with others inside and outside the organization and their potential level of involvement in the matter, and to get an overview of the surrounding facts before jumping into a full review.

Using technology on our review platform, we clustered documents by topics and grouped related documents across concepts that were potentially relevant to the matter. Another tool on the platform allowed us to immediately find high-volume communications between people we had already identified as key, and between previously unknown parties. Setting up this groundwork made running thorough, targeted searches a much easier proposition.

Most review platforms have similar tools. You should work with your outside counsel and other parties to ensure that you're using them to organize your data as efficiently as possible before review even begins.

Analyzing the Data: Tools And Approaches

The proper and exhaustive use of technology to cull and organize the data is a far more desirable and efficient option than simply directing an army of lawyers to sift through data. Technology is the ideal risk mitigation tool — and it can be extraordinarily effective when you know when to use what tools and when you implement an approach that treats technology as the cornerstone of the discovery process.

Say you've conducted a thorough early case assessment, used technology to sort and filter your data, and have a good understanding of what you're looking for. The next step is then to cull down the amount of information that needs to be manually reviewed, while still following a process that is intuitive and defensible in court.

One traditional method involves building search strings that incorporate the information and knowledge that you have and running these searches across the potential data

continued on page 6

Data Review

continued from page 5

universe. A common mistake is stopping the process there and just reviewing everything that hits on these search terms. Instead, at a minimum, this should be an iterative process whereby you sample the results of the initial searches and refine the terms to hone in on the relevant documents and to narrow down the scope of review. In addition, the search term refinement process should be combined with advanced analytics tools to help further identify relevant terms and other ways to reduce the document population for review.

Another more advanced method of analyzing the data and approaching review is through the use of predictive coding. This can be used in many ways to analyze and cull data. Of course, in order to use predictive coding, you must have an understanding of the issues, or at least what is relevant in the matter, as it requires an initial review of statistically valid samples of documents. Once the sample documents have been coded, the system uses this information to translate this coding to other documents with similar characteristics.

In a recent litigation matter that we worked on, predictive coding allowed us to cull a significant number of documents. By coding different subsets of data within the initial set of documents — around 1.5 million — we were able to determine with a high degree of confidence that at least 20% of them were irrelevant to the matter. This process allowed us to get to the relevant documents much faster, increase the quality of review, and to get vital information to counsel more quickly than through linear review.

Letting Facts Dictate Review

Similar to developing search terms, the best way to tackle review is to build an iterative process that evolves as you find key, operative facts and information. It doesn't make sense to wait until the end of review to begin piecing together the facts and creating a narrative about what is going on. In litigation, for example, being able to gather and analyze facts at the outset and in the early stages of review can shape the entirety of your strategy. If, over the course of review, you find that the facts being uncovered overwhelmingly point to your culpability, you might decide it's a wiser move to just go ahead and settle, rather than letting the case drag on in court.

Fact development can also play a major role in controlling the amount of data you need to review. This was especially true in the FCPA case I mentioned previously. After we reviewed an initial set of 50,000 documents (out of over two million), we confirmed that the only relevant and key documents were email conversations. We therefore removed all documents unrelated to e-mail, and refined our search terms to better reflect the facts we were already gathering. This had an enormous effect on the review: we were able to bring the total volume of data down to 400,000 documents and minimize the amount of unnecessary review.

Work closely with your outside counsel and other legal partners during reviews to ensure that you're building an iterative search process and using tools like predictive coding to narrow down the amount of documents that need to be reviewed. Getting to the important facts as quickly and efficiently as possible is paramount in developing a smart strategy.

Shaping Future Reviews and Real-Time Compliance

Large-scale e-Discovery and document reviews yield tremendous amounts of data and insight. It would be wrong to think that the data you analyze and become familiar with in a given case can only be understood and used in the context of that same case. Rather, data gleaned from past reviews can be enormously helping in informing and shaping future reviews — and in building compliance programs that utilize fact development as the first step in identifying and solving issues as they arise.

The most obvious application of data from past reviews is to keep it readily accessible for future use. For example, a government investigation into off-label promotion of a product could lead to a shareholder class action, as well as product liability matters all related to the same product and involving similar issues. If you engaged in a full-scale review during discovery for the initial investigation matter, you could re-use that same data and all of the information gleaned from the initial review regarding manufacturing, marketing and sales practices.

In the situation described above, one way that you could use data previously collected is to look through the initial data set to see if there are any mentions of the plaintiff in a product liability matter or any instances of off-label promotion that could be possibly related. The company would obviously know the patient's location and would have sales records and marketing reports from that region. By running searches across the existing data for the five to 10 custodians who may have been involved in promoting the product in that region, you could try to find what doctors, hospitals, and patients may have been involved and impacted.

Even if this process does not evolve exactly in the manner described above, this is still how companies should be treating legacy data. Documents collected for each matter should be adequately stored for future matters in the event that these documents or subsets of these documents become relevant again. Re-using and re-purposing data can only help you become more familiar with your own company, your organization's lexicon, the way you do business, and the issues that affect you across business functions.

Moving Beyond Review

Fact development is not just about looking for and interpreting facts on a one-off basis as an individual case arises. Instead, companies should treat their databases like a work in progress — something to be turned to in times of need but also something that should grow and be kept up-to-date.

continued on page 8

Revenue

By Michael Goldman

This article is the eighth installment in an ongoing series focusing on accounting and financial matters for corporate counsel.

When is a sale a sale? This question is much more than semantics or a deep philosophical debate that college accounting majors have over a nice cold keg of Mountain Dew. Many an executive or business owner has gone to jail over this issue.

The Revenue Recognition Principle of Accounting

My 1970s vintage accounting text started the revenue chapter with the statement that "Revenue recognition is one of the most difficult and pressing problems facing the accounting profession." Forty years later, it still is.

The Revenue Recognition principle of accounting states that *revenue is recognized when: 1) the earning process is complete or virtually complete; and 2) an exchange transaction has taken place.* Basically, you book the sale when you've earned it and are entitled to be paid. In theory this is simple and straight-forward; a company provides a product or a service, and as soon as they have delivered it they can/should record (recognize) the revenue from that product or service.

We all know that the real world does not always conform to simple theory. What if, for example:

- The product sold has a known high defect or return rate?
- Your business model is selling high-margin goods to very poor credit risks?
- The buyer agrees to advance money to the seller and have the seller hold the product for future delivery?
- The seller is a construction company and the product being sold, a building, takes three years to build?
- The buyer pays on installment?
- The product being sold is delivered on consignment?
- Both a service and a product are provided incidentally to each other but with different timing (such as software plus installation and maintenance services)?
- There is a time element to the product or service, such as a magazine subscription or an insurance policy paid in advance?
- A company ships more product to its customer than the customer ordered?
- A lawyer spends many hours giving a client advice that the client considers bad and doesn't want to pay for?

The answer to all of the above questions, plus most others related to revenue recognition, is the same; "it depends." No matter how many rules or interpretations the accounting rule-making bodies hand down, the decision of when or even whether to record revenue will always reflect the accountant's judgment.

Of course, where there is judgment, there are rules, more rules, and interpretations of rules.

The SEC

The U.S. Securities and Exchange Commission (SEC) states on its website: "The accounting literature on revenue recognition includes both broad conceptual discussions as well as certain industry-specific guidance. If a transaction is within the scope of specific authoritative literature that provides revenue recognition guidance, that literature should be applied. However, in the absence of authoritative literature addressing a specific arrangement or a specific industry, the staff will consider the existing authoritative accounting standards as well as the broad revenue recognition criteria specified in the FASB's conceptual framework that contain basic guidelines for revenue recognition. Based on these guidelines, revenue should not be recognized until it is realized or realizable and earned." The site (http://1.usa.gov/1cqpyh1) then goes on to give many hypothetical questions and the commission's interpretations.

The SEC seems determined that companies should not recognize revenue until as many criteria as possible are met. On the other hand, another powerful government agency, the IRS, would really appreciate, and gets somewhat insistent that, companies recognize revenue (and pay tax on it) as quickly as possible.

General Rules

There are general rules, again subject to the application of judgment, to deal with revenue recognition questions:

- Revenue from the selling of product generally is recognized when the product is delivered.
- Revenue from providing services is generally recognized when the service is provided and billed.
- Revenue from the usage of property (rent, royalties, etc.) is recognized as time passes.
- When the return rate is high or payment is uncertain, revenue should not be recognized until payment is received.
- Under a long-term contract, such as for construction or software installation, revenue can be recognized on an interim (before the end of the contract) basis based on the percentage of completion.
- If the product is a fungible commodity such as copper or corn for which there is a ready market with reasonably assured prices, revenue can be recorded when the product is ready to sell even if no sales have been consummated.
- Installment sales can be recorded either all at once when the agreement is entered into or over time as the installment payments are made.
- Product paid for in advance may have all the revenue recorded at time of payment (buy and hold agreements) or as time passes (such as with magazine subscriptions).

Abuse of the Rules

Of course, deciding what rule you are going to follow for your revenue recognition is only the first half of the issue. How you apply that rule is

continued on page 8

Michael Goldman, MBA, CPA, CVA, CFE, CFF is principal of Michael Goldman and Associates, LLC in Deerfield, IL. He may be reached at michaelgoldman@mindspring.com.

Revenue

continued from page 7

also open to management discretion or abuse. One of the most common abuses is "channel stuffing" — shipping more product to established customers than they ordered or are able to sell. Companies do this to record sales now, and worry about the blow-back later.

More subtle bending of the rules can be easily done. One way to do this is in how you define when a product "shipped." In the fraud case of a publicly held company that I worked on, the definition of "shipped" incrementally changed over time; first, it changed from when product was received by customers to when it was loaded on the trucks to when it was in the staging area ready to be loaded. Later, the definition of the staging area started changing, from within 30 feet of the dock doors to being on a certain side of a yellow line that was drawn in the warehouse (and that kept getting redrawn further and further from the dock doors). The portion of the warehouse that was considered "sold and shipped" kept expanding — not because business was great, but because business was declining and the decline was being hidden by accelerating (and eventually fictionalizing) sales.

In service firms, "delivery" is harder to discern, and more open to manipulation than traditional product sellers. Professional firms especially are prone to either accelerating or holding billings, depending on whether their pressure is to maximize revenue or minimize taxes.

Standards Update

In 2010, the Financial Accounting Standards Board issued an Exposure Draft of a proposed Accounting Standards Update titled "Revenue from Contracts with Customers." It was 170 pages long, was redone in 2012, and has still not yet been decided upon. If you are an insomniac, you can find it at http://www.fasb.org/. The primary issues still under discussion mostly involve timing and collectability. Whenever it is finally issued and becomes GAAP, these pronouncements are still unlikely to answer all revenue recognition questions once and for all, and they definitely will not even address implementation issues such as yellow lines moving across warehouses. What is important for you in any company you are working with is getting a good understanding of exactly what triggers the recording of a sale, how likely the customer is to pay, and when the recording of revenue takes place.

The publisher of this newsletter is not engaged in rendering legal, accounting, financial, investment advisory or other professional services, and this publication is not meant to constitute legal, accounting, financial, investment advisory or other professional advice. If legal, financial, investment advisory or other professional assistance is required, the services of a competent professional person should be sought.

FLSA Actions

continued from page 4

would be a windfall; that allowing such claims to survive would upset a trustee's decision to sell assets piecemeal or as a going concern; and that allowing successor liability would lead to a "flurry of lawsuits" from opportunistic workers seeking to find a solvent defendant for frivolous lawsuits.

In finding against Thomas & Betts, the court concluded, "With these chimeras set to one side, there is no good reason to reject successor liability in this case — the default rule in suits to enforce federal labor or employment laws." 711 F.3d at 769. The Court of Appeals found for Teed and the plaintiffs were entitled to the $500,000 settlement to which the parties had agreed pending the outcome of the appeal.

Fallout and Lessons Learned

The extent to which the Seventh Circuit's holding in *Teed* will be adopted by other Circuits remains unclear. At least one decision from the Southern District of Florida embraces the court's rationale in *Teed*. *See Cuervo v. Airport Servs., Inc.*, 12-20608-CIV, 2013 WL 6170661 (S.D. Fla. Nov. 22, 2013) (finding a cause of action in the Eleventh Circuit for successor liability under the FLSA). Regardless, the *Teed* decision is important for parties (and attorneys) on both sides of the aisle.

First, an acquiring company needs to be cognizant of any pending FLSA litigation being faced by a seller. Incorporating disclaiming language into an agreement is simply not enough to avoid liability. A company must perform a full analysis of the factors implicated by the federal standard for determining successor liability. More to the point, any anticipated exposure resulting from pending FLSA litigation should be incorporated into an offer price.

From the employee's perspective, the decision in *Teed* gives hope to plaintiffs that defendants in FLSA actions cannot escape liability simply by selling off their assets. The violating company will pay for its infractions through a decreased sale price and a plaintiff, if successful in proving his case, will receive compensation for the predecessor's FLSA violations.

Data Review

continued from page 6

Instead of waiting until an issue builds to the point of mandated or court-ordered discovery (when data sizes will inevitability be much higher) companies should engage in a regular analysis of their data and tackle points of suspicion immediately. Discovery should become a continuous, institutional process; literally "discovering" issues as they emerge and analyzing them. The end goal should be to build an internal compliance system that allows companies to track their electronic communications in real time and flag-up suspicious behavior for immediate review.

And how about using data for non-compliance reasons or turning the legal division into a profit

continued on page 12

Whistleblowers

continued from page 1

serve as whistleblowers on their clients. This article describes the variance between SEC whistleblower rules and state ethics rules that led to the October 2013 New York County Bar Association ethics opinion that the federal whistleblower rules create risk of ethics violations such that attorneys should not be financially rewarded for revealing client confidences.

The Dodd-Frank Whistleblower Award Program

Passed in response to the financial crisis of 2008-2009, Dodd-Frank created a whistleblower award program to promote the voluntary disclosure of information leading to successful SEC or related enforcement actions. Under the SEC's rules implementing the Dodd-Frank whistleblower award scheme, adopted in 2011, whistleblowers are awarded 10%-30% of collected fines for providing voluntarily "original information" that leads to the successful enforcement of an SEC action or related action resulting in monetary sanctions of more than $1 million.

Consistent with the policy of encouraging candid client communication with counsel, the SEC's rules generally bar attorneys from eligibility for whistleblower awards by excluding from the definition of "original information" obtained through a communication subject to the attorney-client privilege or in connection with the legal representation of a client. These exclusions recognize the possibility that potential awards of $100,000 or more could influence an attorney's judgment in determining whether to disclose client confidential information to the SEC. In the SEC's Adopting Release for the whistleblower award rules, the SEC made clear its intention to avoid rewarding attorneys for disclosures in violation of their ethical obligations, stating:

> The proposed exclusions … recognized the prominent role that attorneys play in all aspects of practice before the Commission and the special duties they owe to clients. We observed that compliance with the Federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about possible violations, and the attorney-client privilege furthers such consultation. This important benefit could be undermined if the whistleblower award program created monetary incentives for counsel to disclose information about possible securities violations in violation of their ethical duties to maintain client confidentiality.

However, there are exceptions to the exclusions barring attorneys from becoming whistleblowers. An attorney may disclose client confidential information to the SEC and qualify for a whistleblower award if the disclosure would otherwise be permitted under SEC Rule 205.3, the applicable state attorney conduct rules, or "otherwise." Given that the SEC disclosure rules differ appreciably from most attorney ethics rules (as discussed below), a variety of conflicting law is incorporated into the whistleblower rules, raising difficult questions for attorneys considering "reporting out" to the SEC and collecting a whistleblower award.

SEC Attorney Conduct Rules

SEC Rule 205.3 appears in Part 205, the attorney conduct rules promulgated by the SEC in 2003 as required by SOX. Part 205 creates both mandatory and permissive reporting requirements for attorneys "appearing and practicing" before the SEC on behalf of an "issuer."

Part 205 requires mandatory reporting by attorneys "up-the-ladder," within the management structure of the corporate organization, if an attorney becomes aware of evidence of a "material violation" of federal or state law by an issuer. Once the attorney has reported a material violation up a prescribed chain of management and evaluated the response to such report, she has fulfilled her whistleblower responsibilities.

There is no further requirement that the attorney "report out" to the SEC and provide it with client confidential information. However, Part 205 provides for permissive reporting of client confidential information; specifically, under Rule 205.3(d)(2), an attorney may disclose such information to the SEC without the client's consent if the attorney reasonably believes disclosure is necessary for the following reasons:

- to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
- to prevent the issuer from committing or suborning perjury in an SEC investigation or proceeding or perpetrating a fraud on the SEC; or
- to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer in the furtherance of which the attorney's services were used.

As discussed next, this permissive reporting out of client confidences is not entirely consistent with the exceptions to the duty of confidentiality provided in the ABA Model Rules of Professional Conduct and the attorney ethics rules of many jurisdictions, which are more restrictive in significant respects.

Disclosure of Confidential Information Under Attorney Ethics Rules

All jurisdictions and the ABA Model Rules of Professional Conduct (Model Rules) provide for disclosure of confidential information without client consent in certain circumstances. These rules vary as to whether such disclosure is permissible,

continued on page 10

Lawrence S. Spiegel is a partner in the Government Enforcement and White Collar Crime group and General Counsel of Skadden, Arps, Slate, Meagher & Flom LLP in New York. He is a member of this newsletter's Board of Editors. **Esther E. Bloustein** is an attorney in the firm's New York office, and practices in the Office of the General Counsel.

Whistleblowers

continued from page 9

mandatory, or prohibited. This article refers to the Model Rules for ease of discussion.

Model Rule 1.6 gives effect to the attorney's duty of confidentiality. Under Model Rule 1.6(b), disclosure of confidential information is permitted — but not required — in six circumstances where the lawyer reasonably believes necessary, including the following:

- to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; or
- to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.

Thus, SEC Rule 205.3 deviates significantly from the Model Rules and many state ethics rules in permitting disclosure to prevent or rectify "material violations" of law that may not rise to the level of a crime or fraud, which is a disclosure trigger under Model Rule 1.6(b). Further, unlike Model Rule 1.6(b), SEC Rule 205.3 permits disclosure to prevent a material violation regardless of whether the attorney's services were used in furtherance of the violation.

Similarly, SEC Rule 205.3 is broader than Model Rule 1.13, which addresses the organization as client and, according to the comments to the rule, supplements Model Rule 1.6(b) by providing an additional basis for disclosure of confidential information. SEC Rule 205.3 permits disclosure of client confidences to prevent harm to investors as well as to the issuer, whereas disclosure under Model Rule 1.13 is limited to preventing harm to the organization. Specifically, under Model Rule 1.13(c), an attorney may reveal confidential information only where the organization's highest authority insists on or fails to address threatened or ongoing action that is clearly a violation of law and the attorney reasonably believes such violation is reasonably certain to result in substantial injury to the organization. Unlike certain of the exceptions in Model Rule 1.6(b), there is no requirement in Model Rule 1.13 that the lawyer's services be used in furtherance of the violation, although the matter must be related to the lawyer's representation of the organization.

The SEC recognized that its rules could conflict with an attorney's ethical duty of confidentiality and included a statement of preemption in Part 205: "Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern." The SEC also included a safe harbor provision in Part 205: "An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices." At least three bar associations have questioned the SEC's position, and it remains an open question whether the SEC rules in fact preempt state ethics rules.

The "reporting out" provisions of Part 205 generated much controversy and comment at the time, and the controversy has continued with Dodd-Frank creating incentives for whistleblowers. The prospect that an attorney may reap a significant financial benefit for disclosing client confidential information increases the tension between the whistleblower rules and attorney ethics rules, leading to at least one local bar association opinion on the subject.

The 2013 NYCLA Ethics Opinion

In October 2013, due to the tension created by the "prospect of government-rewarded lawyer whistleblowers," the New York County Lawyers' Association (NYCLA) Committee on Professional Ethics issued a formal opinion (Formal Op. 746) concluding that New York lawyers "presumptively may not ethically serve as whistleblowers for a bounty against their clients under the Dodd-Frank … Act, because doing so generally gives rise to a conflict between the lawyers' interests and those of their clients."

This conclusion was based on an analysis of New York Rules of Professional Conduct 1.7 and 1.9, addressing lawyers' responsibilities to current and former clients to avoid conflicts of interest and to safeguard confidential information. The opinion recognized that a conflict of interest between the personal interest of a lawyer and the interest of her client is presented where the lawyer pursues a whistleblower award. The opinion also compared exceptions to the duty of confidentiality under the New York Rules of Professional Conduct with the SEC whistleblower rules, and concluded that "New York lawyers, in matters governed by the New York [Rules of Professional Conduct], may not disclose confidential information under the Dodd-Frank whistleblower regulations, except to the extent permissible under the Rules of Professional Conduct."

The NYCLA opinion echoes earlier opposition to the SEC whistleblower rules from two other bar associations in Washington and California. Shortly after the SEC adopted Part 205, the Washington State Bar Association reached the same conclusion as NYCLA and, in an interim formal ethics opinion that was later withdrawn, warned Washington lawyers not to reveal client confidences and secrets unless authorized to do so by the Washington Rules of Professional Conduct. Wash. State Bar Assoc., Interim Formal Ethics Op. Re: The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs (available at http://bit.ly/1gVmcUb).

Not long after, the Corporations Committee of the California State Bar published a comprehensive analysis of the intersection of the SEC rules with California attorney conduct rules and cautioned that "[a]n attorney relying upon the SEC's safe harbor in disclosing client confidences to the SEC would be doing so at his or her own peril." Corps.

continued on page 11

Whistleblowers

continued from page 10

Comm. of Bus. Law Section, Cal. State Bar, Conflicting Currents: The Obligation to Maintain Inviolate Client Confidences and the New SEC Attorney Conduct Rules, 32 *Pepp. L. Rev.* 89, 149 (2004). In contrast, in a 2005 ethics opinion, the North Carolina State Bar reached the opposite conclusion, stating, in reliance on a presumption that the SEC rules preempted state law, that a North Carolina attorney "may, without violating the North Carolina Rules of Professional Conduct, disclose confidential information as permitted by Rule 205 although such disclosure would not otherwise be permitted by the NC Rule." N.C. State Bar, 2005 Formal Ethics Op. 9.

Conclusion and Considerations

In most cases, an attorney fulfills her responsibilities under both the SEC rules and state ethics rules by reporting up problematic conduct within the client organization. However, for an attorney who contemplates also reporting out of the organization as a whistleblower, the conflicts between the SEC whistleblower rules and state attorney conduct rules create an uncertain pathway. Applicable attorney ethics rules may render improper such a disclosure — even where it is consistent with the SEC rules.

Indeed, there are several examples of attorneys facing disciplinary or other sanctions for disclosures made as whistleblowers in other contexts (*see e.g., U.S. ex rel. Fair Lab. Practices Assocs. v. Quest Diagnostics Inc.*, 734 F.3d 154 (2d Cir. 2013) (affirming district court holding that former general counsel to defendant violated ethical obligations by participating in *qui tam* action pursuant to False Claims Act and holding that the district court did not err in dismissing complaint and disqualifying plaintiff, its general partners including former general counsel, and outside counsel from subsequent litigation)) and a developing body of case law that considers the limitations ethical obligations such as the duty of confidentiality impose on whether attorneys may state claims for retaliation under whistleblower protection laws.

Moreover, where such reporting out of an organization is expressly permitted under applicable state ethics rules, the conflict of interest raised by the prospect of a substantial financial reward to counsel may itself create a violation of ethics rules. In the face of this, more state and local bar associations are likely to follow NYCLA and make clear that "disclosure of confidential information in order to collect a whistleblower bounty is unlikely, in most instances, to be ethically justifiable."

Securities Fraud

continued from page 2

Basic's presumption, although rebuttable, provided major assistance to plaintiffs' lawyers in seeking class certification. It made certification, often a major challenge for plaintiffs in other types of class actions, easy to obtain in securities class actions.

Questions from the Outset

Basic had its doubters from the start. Justices White and O'Connor dissented from the part of Justice Blackmun's opinion adopting the fraud-on-the-market approach, contending, among other things, that the efficient-market economic theories upon which the presumption relied "are — in the end — nothing more than theories which may or may not prove accurate upon further consideration."

And since the *Basic* Court's adoption of the presumption, a number of academics have disputed the efficient-market theory, contending that it fails to capture the behavior of all or even most investors, some of whom are searching for undervalued stocks, or stocks that the market has not correctly valued based upon available information — which would suggest that the market is inefficient, not efficient.

Thus, the defendants in *Haliburton* and their supporters who have filed amicus briefs contend that the theoretical premise of *Basic* no longer applies. Indeed, the defendants in *Haliburton* were likely encouraged to pursue a direct attack on *Basic* by the statements of four justices — Justices Alito, Kennedy Scalia and Thomas — in dissenting or concurring opinions in *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, 133 S. Ct. 1184 (2013), who in varying ways signaled, at the very least, an openness to hearing a challenge to *Basic*.

Ironically, *Amgen* itself was decided favorably to class action plaintiffs on a separate, though not unrelated, securities fraud issue: whether plaintiffs had to demonstrate the materiality of alleged misrepresentations or omissions in obtaining class certification under the fraud-on-the-market presumption of reliance. Justice Alito agreed that this was not required under *Basic*, and thus did not dissent from the Court's decision, but in his concurrence wrote that "recent evidence suggests that the [fraud-on-the market] presumption may rest on a faulty economic premise."

Also ironic is that the underlying litigation in *Haliburton* has already generated a Supreme Court decision, in 2011, and that that decision too was decided favorably to the plaintiffs on the issue of whether loss causation had to be proven by plaintiffs on a class certification motion. *Erica P. John Fund, Inc. v. Haliburton Co.*, 131 S.ct. 2179 (2011) ("*Haliburton I*").

Haliburton I

The underlying complaint alleges claims against Haliburton and its CEO concerning alleged misstatements as to the company's revenues, asbestos liability and the benefits of a 1998 merger between Haliburton and Dresser Industries.

The chain of events leading to *Haliburton I* began with the district court's denying class certification, based on the plaintiff's failure to satisfy the loss causation element

continued on page 12

Securities Fraud

continued from page 11

of a securities fraud claim. The Fifth Circuit affirmed. In *Haliburton I*, however, the Supreme Court held unanimously that proof of loss causation was not required at the class certification stage.

When the case returned to the district court to decide the issue of class certification in light of the Supreme Court's decision, Haliburton continued to argue against certification, now on the basis that its evidence demonstrated that the alleged misrepresentations did not affect the price of Haliburton stock.

But the district court refused to consider this evidence, on the basis that Haliburton could not rebut the fraud-on-the market presumption on a class certification motion by proving an absence of price impact. The Fifth Circuit affirmed.

By this time, *Amgen* had been decided. And the Fifth Circuit portrayed the issue of price impact as analogous to the issue of materiality dealt with in *Amgen* — that is, a merits issue as to which the plaintiff would have to prevail at trial to win the case (although "price impact" itself is not a separate element of a 10b-5 claim, it is something a plaintiff would have to demonstrate to establish loss causation, which is an element). If Haliburton succeeded at trial in proving lack of price impact, all plaintiff's claims would fail, which to the Fifth Circuit meant that price impact is not relevant to whether common issues predominate, the issue for class certification.

Thus, the Fifth Circuit stated, under the reasoning of *Amgen*, the district court was correct in declining to consider price impact evidence.

The Case on Appeal

In its appeal to the Supreme Court, Haliburton raises this narrower issue upon which the Fifth Circuit decided the case: whether a defendant may rebut the *Basic* presumption of reliance at the class certification stage by "introducing evidence that the alleged misrepresentation did not distort the market price of its stock."

But it further raises the broader question of whether the Court "should overrule or substantially modify" *Basic's* recognition of "a presumption of class wide reliance derived from the fraud-on-the-market theory."

Although the Supreme Court's grant of certiorari has provoked speculation that *Basic* will be reversed, the outcome of the case is by no means clear. Defendants are heartened by the fact that the four justices critical of the fraud-on-the-market theory said what they did in *Amgen*. Many believe those four are inclined to overrule *Basic*. But plaintiffs' lawyers believe that at least four of the other five justices — Justices Ginsburg, Kagan, Breyer and Sotomayor — are leaning the other way. Many believe the key question is how Chief Justice Roberts, who joined the plaintiff-favorable decisions in *Haliburton I* and in *Amgen* but is more often aligned with the four justices critical of *Basic*, will view the case.

While the critics of *Basic* focus on academic literature challenging the efficient-market hypothesis, both the plaintiffs' and the United States' briefs maintain that the presumption does not depend on the proposition that markets are always efficient, and that the academic debate about whether markets "correctly" value securities is irrelevant. The *Basic* supporters' key argument, however, may be that Congress has "acquiesced" in the presumption. Since *Basic*, Congress enacted the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998, modifying the scope of the private right of action under section 10(b) but not modifying the fraud-on-the-market presumption.

Conclusion

Even if the fraud-on-the-market presumption survives, the case could still result in a change of the status quo in securities litigation if the Court's decision permits defendants to rebut the presumption of reliance at the class certification stage, by introducing evidence that any misrepresentations did not distort the market price. Defendants can do that now at trial, but many defendants find it too risky to go to trial where a plaintiff class has been certified, causing companies to settle cases before trial. The ability to wage that fight at class certification could enable defendants to fight class certification more effectively, and thus develop greater leverage in negotiating settlements before certification is decided.

Data Review

continued from page 8

center instead of just a cost center? Imagine being able to take all the knowledge you have gleaned during reviews — for example, which sales and marketing practices and individuals are the most likely to cause issues downstream — create reports, and sell it back to different internal business units. Or say you have an enormous amount of data surrounding your sales initiatives. Why not examine your strategies, see what's working and what's not, and share your learnings with your marketing department?

Facts are stubborn things, John Adams once said. They're also incredibly useful.

To order this newsletter, call:
1-877-256-2472

On the Web at:
www.ljnonline.com