

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 a securities litigation repeat player such as a D&O insurer or broker. Most mistakes in securities litigation are made before the first pleading is filed – selection of counsel who doesn’t have the right expertise, experience, or economics for the particular case, or who is hard to work with. This paper discusses the steps every company should take and the issues they should consider in choosing defense counsel that is right for them and their particular case.

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

If you or your company has been named in a securities class action, there are many complex issues to consider. Fortunately, the process set out by the Private Securities Litigation Reform Act (the Reform Act) gives you some breathing room before most decisions – including the all-important decision of whom you will select to defend your case – need to be made. 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 large group of lawyers that descends upon a company after a suit is filed. And it can be a serious error to use a law firm name or general reputation as a proxy for quality and fit for this type of litigation or your particular case.

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 on 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 never are the right firms to exclusively evaluate whether they are.
5. Select a full-time securities defense lawyer, not a commercial litigator who defends multiple types of litigation. There is a relatively small national bar of full-time securities defense lawyers. They're steeped in the law and know the plaintiffs' bar, D&O insurers, and mediators. That expertise tends to produce better results.
6. Search for value, i.e., 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. We used to say you should conduct interviews in person at your office. But the pandemic taught us we can work well virtually around the globe, and litigation is increasingly virtual and geographically agnostic anyway. You can use this new reality to expand your field of defense counsel candidates and reduce cost.
10. Look beyond the motion to dismiss. This means engaging a lawyer with proven experience in defeating cases at class certification and summary judgment. More than half of all cases survive a motion to dismiss, so you need to plan for that contingency.

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

The Economics of Securities Litigation Matter

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 established securities

plaintiffs' firms with significant resources and mostly institutional clients that tended to bring larger securities class actions against larger companies. But after the onset of securities class actions in 2010 stemming from the Chinese reverse mergers, additional plaintiffs' firms with retail investor clients – sometimes called "emerging" firms – have been initiating the lion's share of cases. One consequence of this expansion of the securities plaintiffs' bar is that most securities class actions are filed against companies with smaller market capitalizations – in fact, about two-thirds are filed against companies with a market capitalization less than \$3 billion.

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, in our view, the biggest risk directors and officers face from securities litigation.

Obviously, companies and their directors and officers should not be subjected to this hazard – which is 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 up-front 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

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 public companies purchase a significant good or service, from coffee machines to architects, they typically seek competitive

proposals. 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 making a decision on counsel to defend a securities class action. Unlike in 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 the 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 advisers – often former colleagues of the in-house counsel – and usually have made sacrifices for the client such that they, the corporate lawyers, expect to be “repaid” through engagement to defend whatever litigation might arise. A big litigation matter is what makes all the miscellaneous loss-leader work worth it.

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 these assertions are flawed. It is always – without exception – in the defendants’ 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 off the case to the litigators of the company’s corporate firm without a competitive interview process. (We address the conflict issue below.)

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’ worth 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 its 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 it 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 their 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 it isn’t, 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 they need lawyers they can trust to walk them through the process. Interviewing is the best way to find the lawyers who have the combination of relevant characteristics – including skills, strategy, and bedside manner – that best fit the defendants’ needs.

Potential Problems of 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 face 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 when establishing 10b5-1 plans and periodic stock sales – and also 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:

- Drafted the disclosures that plaintiffs challenge, so 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 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 without 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.
- Did not update 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 omission of a

fact, the lawyer's advice that there was no duty to disclose it 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 the 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 the 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.

All of this said, it is sometimes completely appropriate for a company's corporate firm to defend securities litigation. But whether or not that is so should be based on an objective analysis, and that analysis is almost always best done through an interview process that includes several additional firms and involvement of the board.

Pay Attention to Economics

Perhaps one factor discouraging companies from conducting an interview process is the daunting prospect of selecting candidates to interview from among the numerous, substantially similar firms that hold themselves out to have securities litigation expertise. 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 they claim theoretical damages in the hundreds of millions or billions of dollars in the lion's share of cases. While 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 still are substantial.

Busy CEOs and CFOs, the typical individual defendants, rely on their in-house lawyers' recommendation of which firm or firms to interview or hire. Boards frequently 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. Nearly all cases are brought by a relatively small group of plaintiffs' firms that have a playbook well known to experienced defense counsel.

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.

The Importance of Looking at National Securities Litigation Specialists

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 at that location, the lead lawyer handling a case should live where the judge and clients live. Right?

Not anymore. And that's especially true since the pandemic taught us that we can effectively and collaboratively work remotely.

But even before the pandemic, litigation was increasingly virtual and national. We don't file pleadings at the courthouse. We file them on the Internet from anywhere. There are increasingly few in-person hearings, and no hearings in some cases. And after the pandemic, many hearings are virtual, as judges have learned that they too can work well virtually. At one of our virtual motion-to-dismiss hearings (which we won) during the pandemic, the judge said he was going to continue to hear motions virtually after the pandemic because it is equally effective and more efficient for the court and the parties.

Clients and lawyers are now used to working together virtually, and even before the pandemic, the reality was that most clients didn't want their lawyers hanging around in person at their offices – email,

phone calls, and videoconferences sufficed. 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, along with virtual depositions being the norm during the pandemic, depositions often don't require much time in the forum city either.

The bottom line of all this is simply common sense. Within the right 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.

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.
- Look beyond the motion to dismiss and choose a lawyer who can effectively and efficiently defend the litigation through class certification and summary judgment.

We're confident that if you carefully and conscientiously follow these steps, 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 SEC and Department of Justice 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 also are sensitive to the economics of each case. 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. This is our top priority in every case and at the heart of everything we do.

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