Business Torts Litigation
FROM THE SECTION OF LITIGATION BUSINESS TORTS LITIGATION COMMITTEE

Spring 2012, Vol. 19 No. 3

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ARTICLES

Updating Federal Procedures for Removal and Venue

By Thomas A. Gilson – May 8, 2012

For years, federal courts have clashed over the interpretation of procedures for removal, jurisdiction, and venue. In the Federal Courts Jurisdiction and Venue Clarification Act of 2011, H.R. 394, P.L. 112–63, a new law that took effect in January 2012, Congress resolved many of these disagreements and clarified lingering ambiguities.

The Act Clarifies Procedures for Removal

A defendant that is sued in state court may remove the lawsuit to federal district court if there is federal-question or diversity jurisdiction. 28 U.S.C. §§ 1331–32. To initiate removal, a defendant must file a notice of removal with the federal district court within 30 days after it is served or otherwise receives a copy of the complaint. The procedures for removal are set forth in 28 U.S.C. §§ 1441, *et seq.*

Timing of Removal in Cases Involving Multiple Defendants

Before the act went into effect, the removal statute stated that the defendant had 30 days to remove an action after receiving a copy of the complaint. *See* 28 U.S.C. § 1446(b) (2010). The statute, however, did not specify how deadlines would be calculated if multiple defendants were served separately at different times.

Resolving a split in authority, the act now gives each defendant an opportunity to remove within 30 days after being served. 28 U.S.C. § 1446(b)(2)(B)–(C). To illustrate how this new provision works, suppose a complaint names two defendants: A and B. The plaintiff serves A first, but A does not file a timely notice of removal. The plaintiff then serves B. Under the act, B still has 30 days from the time it is served to file a notice of removal, even though A's deadline has expired.

Stated differently, a plaintiff may not deprive a defendant of its opportunity to remove the case to federal court by serving one defendant first, and then waiting more than 30 days to serve a second defendant. The act also clarifies that an earlier-served defendant may join a later-served defendant's notice of removal, even though the earlier-served defendant's own 30-day time period has expired. 28 U.S.C. § 1446(b)(2)(C).

Notably, this provision comes into play only when multiple defendants are served at different times. If multiple defendants are served on the same day, of course, all of them will have the same removal deadline.

Codifying the Rule of Unanimity

The act addresses another issue relating to the removal of multi-defendant cases—it codifies the long-established "rule of unanimity," under which all defendants that have been properly joined and served must consent to removal. 28 U.S.C. § 1446(b)(2)(A).

Is the Complaint Removable?: When Federal Jurisdiction Is Unclear
Assume that a state-court complaint specifically asserts claims under a federal statute. There is no question that the 30-day time period for filing a notice of removal starts to run when a defendant receives a copy of such a complaint. But what if it is unclear that there is federal jurisdiction over the state-court complaint?

The act provides guidance to defendants who are served with complaints that do not explicitly reveal that federal jurisdiction exists—in particular, when a complaint does not clearly indicate an amount in controversy. 28 U.S.C. § 1332 (to establish diversity jurisdiction, the amount in controversy must exceed $75,000). When a complaint in state court does not specify the amount of damages it seeks, a defendant may attempt to persuade the federal district court judge that the $75,000 amount-in-controversy requirement has been satisfied. This is often a challenging process, as the defendant may not yet have any meaningful evidence about the plaintiff's damages. Moreover, federal courts have disagreed about the standards a defendant must meet to establish that the amount-in-controversy requirement has been met.

Under the act, a defendant may simply allege in its notice of removal that the amount in controversy exceeds $75,000. 28 U.S.C. § 1446(c)(2). The defendant must persuade the federal district court judge that the amount-in-controversy requirement has been satisfied under a preponderance of the evidence standard—not the more demanding "legal certainty" standard previously used by some courts. *See Pratt Cent. Park Ltd. v. Dames & Moore*, 60 F.3d 350, 351 (7th Cir. 1995); *Columbia Gas Transmission Corp. v. Tarbuck*, 62 F.3d 538, 541 (3d Cir. 1995). Thus, if the district court judge is convinced, and the other diversity jurisdiction requirements have been met, the defendant has met its burden of establishing that removal is proper.

If the defendant learns during the course of proceedings in state court that there is a basis for federal jurisdiction—for example, the plaintiff files an amended complaint that raises a federal claim—the defendant will have 30 days to file a notice of removal. 28 U.S.C. § 1446(b)(2)(B). Likewise, if the defendant learns for the first time through state-court discovery that the amount in controversy exceeds $75,000, the defendant has 30 days to file a notice of removal based on diversity jurisdiction after learning that fact. 28 U.S.C. § 1446(c)(3)(A).

Extending the One-Year Time Limit for Removal
The removal statute sets forth an outside time limit for state-court defendants that want to remove a lawsuit on diversity grounds: one year from the commencement of the lawsuit. 28 U.S.C. § 1446(b). Congress recognized that some state-court plaintiffs were using delay tactics and concealing facts that would support diversity jurisdiction until after the one-year period had expired. The act, therefore, now provides that the one-year time period may be extended if the court concludes that a plaintiff has acted in bad faith to prevent removal. 28 U.S.C. § 1446(c)(1).

The Removal of State-Law Claims
The act also addresses the removal of state-court lawsuits that include both federal claims and unrelated state-law claims. Before the act went into effect, federal courts had discretion to accept

jurisdiction over unrelated state claims when a complaint was removed on federal-question grounds. 28 U.S.C. § 1441(c) (2010). Many courts and commentators viewed this procedure as constitutionally suspect because it appeared to afford federal courts the right to hear state-law claims they would have lacked jurisdiction to hear initially. *See, e.g., Salei v. Boardwalk Regency Corp.*, 913 F. Supp. 993, 1007 (E.D. Mich. 1996); Charles A. Wright and Mary K. Kane, *Law of Federal Courts* § 39 at 235 (6th ed. 2002). In response to these critiques, the act now requires federal district courts to sever unrelated state-law claims and remand them to state court. 28 U.S.C. § 1441(c)(2).

To be clear, district courts need not sever *all* state-law claims in a removed complaint, as federal courts have supplemental jurisdiction to hear state-law claims that are substantially related to federal claims.

Diversity Jurisdiction: Defining the Citizenship of Corporations

The act clarifies how corporations with foreign contacts should be treated in diversity cases. Before the act went into effect, the diversity statute stated that a corporation was a citizen of any "State" where it was incorporated and of the state where it has its "principal place of business" or its headquarters. *See* 28 U.S.C. § 1332(c)(1) (2010). The federal appellate courts treated this provision inconsistently, with some interpreting the term "State" to include foreign states, and some concluding the contrary. *Compare, e.g., Torres v. Southern Peru Copper Corp.*, 113 F.3d 540, 543 (11th Cir. 1997) (statutory term "State" does not refer to foreign states) *with Nike, Inc. v. Comercial Iberica de Exclusivas Deportivas, S.A.*, 20 F.3d 987, 990 (9th Cir. 1994) ("State" applies to both foreign countries and states of the United States). This led to confusion in determining the citizenship of foreign and domestic corporations with a presence in the United States and abroad.

Resolving this circuit split, the act clarifies that a corporation is a citizen of both the state or country in which it was incorporated and the state or country where its "principal place of business" is located. 28 U.S.C. § 1332 (c)(1). For example, it is now clear that there will be no diversity jurisdiction in a lawsuit between a citizen of New York and a Chinese corporation whose principal place of business is in New York. In that instance, the Chinese corporation would be considered a citizen of New York, thus destroying diversity.

The Act Updates Procedures for Venue

The act also makes several tweaks to the laws governing venue. First, there were formerly two statutory provisions for venue: one for diversity cases, 28 U.S.C. § 1391(a) (2010), and another for federal-question cases, 28 U.S.C. § 1391(b) (2010). The act abolishes this distinction and establishes a new, unitary provision, 28 U.S.C. § 1391(b), that covers venue for both types of cases.

Second, venue was formerly proper in "a judicial district where any defendant resides, if all defendants reside in the same state." *See* 28 U.S.C. § 1391(a)(1) & (b)(1) (2010). Congress recognized that this language was problematic in cases involving corporate defendants. To

illustrate the problem, suppose a complaint names two defendants: an Arizona resident and a corporation that does substantial business in every state, including Arizona. The corporation is treated as a resident of every state, including Arizona. 28 U.S.C. § 1391(c). Under the former language of the statute, because the corporation and the individual are deemed to both "reside" in Arizona, venue would seem to be proper in any other district where the corporation resides (the District of Maine, for example). The act clarifies that venue should not be treated so expansively. Now, in multi-defendant cases, venue is limited to a district of the state where all the defendants reside. 28 U.S.C. § 1391(b)(1). In our example, venue would be proper in the District of Arizona, but would not be proper in the District of Maine.

Finally, the act addresses the standards for transferring venue from one federal district to another. Civil actions may be transferred from one federal district to another for the convenience of parties and witnesses and in the interest of justice. 28 U.S.C. § 1404(a). Before the act was passed, there was one important caveat: A lawsuit could only be transferred to a district where the lawsuit could have been filed initially—that is, where venue and personal jurisdiction would have been proper. The act eliminates this restriction, permitting federal lawsuits to be transferred to almost any district as long as all parties agree, even if the lawsuit could not have been brought in that district originally. *Id.* Such a transfer will be permitted only if the court agrees that it would be in the interest of justice and that it would be convenient for the parties and witnesses.

Conclusion

The act makes significant changes to the federal jurisdictional statutes. These changes are worthy of careful consideration, as they could affect your clients' rights to defend themselves in federal court.

Keywords: litigation, business torts, Federal Courts Jurisdiction and Venue Clarification Act, jurisdiction, federal district court

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A Primer for the Alien Tort Claims Act

By Ashish S. Joshi and Gabriele Neumann – May 8, 2012

Every U.S. company doing business overseas—especially in developing economies—should be interested in the outcome of two cases that are currently before the Supreme Court of the United States. In *Kiobel v. Royal Dutch Petroleum Co.* and *Mohamed v. Palestinian Authority*, the Supreme Court faces the issue of whether corporations can be sued for violations of international law under U.S. statutes, including the Alien Tort Claims Act. These cases involve tort claims against non-natural persons—oil companies are alleged to have aided and abetted international law violations in Nigeria in *Kiobel*, and the Palestinian Authority is alleged to have committed torture and extrajudicial killing in *Mohamed*.

A Brief History of the Alien Tort Claims Act

The Alien Tort Claim Act was adopted in 1789 by the first U.S. Congress. In essence, the statute permits suits by aliens in federal courts for certain international-law violations, including human-rights violations. It provides jurisdiction only for those claims alleging violations of "the law of nations or a treaty of the United States." 28 U.S.C. § 1350. The plain text of the statute grants "[t]he district courts . . . original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." Despite the fact that the legislation of this statute dates back to 1789 (or perhaps because of it—occurring only a few decades after American independence, there are few surviving records to document legislative history from this era), the intent of the drafters cannot be easily ascertained. Congress's precise intentions in enacting the Alien Tort Claims Act are unknown. *See IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1015 (2d Cir. 1975) ("no one seems to know whence it came").

One theory is that Congress wanted to provide a "means by which the U.S. could fulfill its international obligations to vindicate a very discrete set of damage claims by diplomats and other foreign nationals injured or abused by Americans." *See* Rivkin &, D. and Casey, L., "Bringing 'Alien Torts' to America," *The Wall Street Journal* (Feb 28, 2012). Whatever the reason for its original adoption, it was little used for nearly two centuries until the 1980s, when activists and plaintiff's lawyers discovered this powerful weapon in their arsenal and began using the Alien Tort Claims Act as a means of suing foreign nationals, U.S. nationals, and companies in federal court for alleged human-rights abuses and/or violations of international law overseas.

Corporations: Sitting Ducks for Alleged Violations of International Norms

A pivotal decision that breathed new life into the alien tort litigation was the Second Circuit Court of Appeals decision in *Filartiga v. Pena-Irala*, 630 F.2d 876 (2d Cir. 1980). In *Filartiga*, the plaintiffs, citizens of Paraguay, brought suit in the Eastern District of New York against another Paraguayan citizen for the wrongful death of the plaintiffs' son. The plaintiffs alleged that the defendant, a former inspector general of police in Paraguay, had tortured and killed the plaintiffs' son in retaliation for the plaintiffs' political beliefs. The plaintiffs initially sued the defendant in Paraguay, but their attorney was imprisoned, threatened with death, and disbarred.

Id. at 878–80. Thereafter, the plaintiffs, through their daughter (then living in the United States), sued the defendant (also at that point residing in the United States) for causing the death of their son in violation of "the law of nations." *Id*. at 880. Finding in favor of the plaintiffs, the Second Circuit held that the Alien Tort Claims Act creates jurisdiction and a cause of action in cases involving international human-rights violations. *Id.* at 887–88.

After *Filartiga*, there has been a steady stream of litigation involving the Alien Tort Claims Act. While *Filartiga* was a cause of action between private individuals, the courts have applied it to corporations as well, beginning with *Doe v. Unocal*, 963 F.Supp. 880 (C.D. Cal. 1997). The act became a way to sue both foreign and domestic persons and corporations, not only for the actions the entities themselves took, but also for actions perpetrated by foreign governments with which those entities conducted business in violation of "the law of nations."

This type of aiding-and-abetting liability reached its zenith in *Khulumani v. Barclay National Bank Ltd*., 504 F.3d 254 (2d Cir. 2007), a case that was brought in Manhattan's federal district court against dozens of U.S. companies that had done business with the South African government during that country's apartheid years. After the trial court dismissed the case in 2002, the Second Circuit partially reversed that decision, allowing the claims brought under the Alien Tort Claims Act to go forward. The Supreme Court initially agreed to review the case but, later, reversed its decision because too many justices would have had to recuse themselves for owning shares in one or more of the defendant companies. The Second Circuit decision that corporations could be sued under the Alien Tort Claims Act for doing business with the wrong government stands.

In 2010 and 2011, four circuits weighed in on corporate liability under the Alien Tort Claims Act. The most infamous of these is arguably the case of *Kiobel v. Royal Dutch Petroleum*, 621 F.3d 111 (2d Cir. 2010). The plaintiffs in *Kiobel* were Nigerian citizens who sued Royal Dutch Shell and a Nigerian affiliate for human-rights violations that occurred in conjunction with the Nigerian government during the course of Royal Dutch Shell's operations there. *Id.* at 117. When the defendants moved to dismiss the plaintiffs' claims, the district court upheld in part and dismissed in part with regards to the specific counts alleged. *Id.* at 124. The Second Circuit Court of Appeals examined the "customary international law" to determine whether corporate liability would be appropriate at all. While American law has long recognized corporate personhood and liability, the Second Circuit determined that the provisions of international law historically had been applied against states or individuals, but not corporations. *Id.* at 119–20. The Second Circuit concluded that the Alien Tort Claims Act does not confer jurisdiction over corporations, as corporate liability is not a part of the "customary international law." *Id*. at 145.

The other three circuits to confront the issue in the past few years, however, have all ruled differently. In *Doe VIII v. Exxon Mobil Corp.*, 654 F.3d 11 (D.C. Cir. 2011), the plaintiffs, a group of Indonesian villagers, sued Exxon Mobil for extrajudicial killing, torture, and prolonged arbitrary detention, among other tort claims, in conjunction with its operations in Indonesia. The D.C. Circuit Court of Appeals examined in depth the history of the Alien Tort Claims Act,

tracing corporate tort liability as a widely judicially accepted principle back to the time of the drafting of the act itself. Thus, the court reasoned, such liability would have been within the intent of the drafters of the statute. *Id.* at 47–8. The court specifically refused to follow the Second Circuit's analysis in *Kiobel* and held that corporations could be held liable under the act for their actions overseas. *Id.* at 50–7.

In *Flomo v. Firestone Nat. Rubber Co.*, 643 F.3d 1013 (7th Cir. 2011), 23 Liberian children sued Firestone National Rubber Co. for utilizing hazardous child labor in the operation of plantations in Liberia. The Seventh Circuit Court of Appeals rejected the analysis in *Kiobel* as incorrectly decided in its reliance on the dearth of international criminal litigation against corporations. *Id.* at 1017. Although it denied the plaintiffs' claims, the Seventh Circuit found that corporate civil liability is "common around the world" and determined that there is no reason not to subject corporations to liability under the Alien Tort Claims Act. *Id.* at 1019, 1021.

Recently, the Ninth Circuit Court of Appeals decided *Sarei v. Rio Tinto*, ___ F.3d ___, 2011 WL 5041927 (9th Cir. 2011). The plaintiffs in that case were natives of Papua New Guinea who sued the defendant as a result of an incident in the 1980s in which an uprising resulted in the use of military force and multiple deaths. The plaintiffs sought to hold the defendant liable for genocide and war crimes under the Alien Tort Claims Act. Disregarding *Kiobel*, the Ninth Circuit Court of Appeals found that there was no explicit bar to corporate liability in the act itself. *Id.* at *20.

The Circuit Split

Many hope that, in *Kiobel* and *Mohamed*, the Supreme Court will bring certainty to the issue of whether private corporations are liable for violating human-rights norms under international law and, therefore, subject to liability under the Alien Tort Claims Act. The Supreme Court has earlier acknowledged that private-party liability for violations of the "law of nations" is exceptional and cannot be lightly assumed. *See Sosa v. Alvarez-Machain*, 542 U.S. 692, 719–20 (2004). Traditionally, international law has defined the rights and obligations of sovereigns, and, accordingly, most norms apply to sovereigns alone and not to their citizens. This general rule has historically recognized a narrow exception. One such exception has been for *hostis humani generis* ("enemies of mankind")—piracy. *See Tel-Oren v. Libyan Arab Republic*, 726 F.2d 774, 781 (D.C. Cir. 1984).

Barring piracy, customary international law has traditionally governed only the relations of sovereigns. A survey of international legal literature finds "embarrassingly little evidence of an international consensus (or even of international support) in favor of imposing liability on private corporations for general violations of customary international law." *See* Julian Ku, "The Curious Case of Corporate Liability Under the Alien Tort Statute," 51 *Va. J. Int'l L.* 353, 355 (2011). Even the London Charter, which created the International Military Tribunal at Nuremberg, did not confer jurisdiction over private corporations, but only over "persons who . . . as individuals or as members of organizations," committed certain crimes. *Khulumani*, 504 F.3d at 321–22. The corporate entities did not stand in the dock at the Nuremberg trials after the Second World War. The few entities that were "punished" by dissolution were a result of a political decision by the

victorious Allies. *See Rivkin & Casey*, supra. Another example of absence of corporate liability for violation of international law and/or human rights norms is the international criminal tribunals established by the U.N. Security Council to prosecute war crimes in the former territories of Yugoslavia and Rwanda. Neither tribunal has brought charges against any juristic persons.

Moreover, treaty law generally does not provide direct support for corporate liability. Almost every treaty imposes liability indirectly by formally imposing an obligation on state parties to impose duties or obligations on private parties. "Treaties cannot impose duties on private parties directly because private parties are not competent to make treaties under international law." Ku, supra, at 384. For example, the Convention Against Bribery of Foreign Government Officials does not regulate juristic persons directly, but instead requires that state parties do so.

Alien Tort Litigation: The Road Ahead

Often, corporate defendants simply settle alien tort claims to avoid bad publicity, enormous legal expense, and the uncertain risk of a negative outcome. *See, e.g.*, "*Wiwa v. Shell*: The $15.5 Million Settlement," *Am. Soc. Of Int'l L. Insights*, (Sept. 9, 2009) ("The cost of ongoing litigation and prospect of negative publicity from the trial (regardless of the verdict) probably played a role in the defendants' willingness to settle on the eve of trial"). Lawsuits brought under the Alien Tort Claims Act alleging violations by corporate defendants of uncertain legal norms in multiple (at times unspecified) instances that occurred in foreign lands and against foreign victims pose a series of difficulties not only to the litigants, but also to the courts. In *Khulumani*, Judge Edward Korman described some of these difficulties:

> The portions of the complaints relating to defendants' alleged conduct focus principally on their trade with South Africa. Thus, car companies are accused of selling cars, computer companies are accused of selling computers, banks are accused of lending money, oil companies are accused of selling oil, and pharmaceutical companies are accused of selling drugs. The theory of the complaints is that in this way defendants facilitated or "aided-and-abetted" apartheid and its associated human rights violations. . . . had they not done so, the apartheid regime would have collapsed, apartheid would have ended sooner, and plaintiffs would not have suffered some or all of their injuries. The causal theory advanced by the . . . plaintiffs is even weaker: "Apartheid would not have occurred in the same way without the participation of defendants."

Khulumani, 504 F.3d at 294 (Korman, J., dissenting).

Car companies sued for aiding and abetting human-rights violations for selling cars and trading with the wrong government? What's next? Should the Alien Tort Claims Act be used to enforce international environmental norms against multinational companies? *See* Pauline Abadie, "A New Story of David and Goliath," 34 *Golden Gate L. Rev.* 745 (2004). Should the act be used to combat foreign child labor? *See* Vanessa Waldref, "The Alien Tort Statute after Sosa: A Viable Tool in the Campaign to End Child Labor?" 31 *Berkeley J. Emp. & Lab. L.* 160 (2010).

These are not far-fetched notions. If the Supreme Court does not bring certainty to corporate liability and restrict it in alien tort litigation, it appears inevitable that U.S. corporations will be sued for these and other novel claims. Corporations may no longer turn a blind eye to possible violations of human rights occurring overseas and/or by foreign affiliates. Although the legal doctrine of corporate personhood is a relatively recent phenomenon and "the law of nations" has only recently been applied to corporations, the stream of cases arising under the act shows no signs of stopping.

It is anticipated that the Supreme Court's decisions in *Kiobel* and *Mohamed* will bring more certainty to this area of the law. Meanwhile, savvy business litigators must keep abreast of the Alien Tort Claims Act. Indeed, juries have awarded multibillion-dollar verdicts in Alien Tort Claims Act cases. *See, e.g, Doe I v. Karadzic*, No. 93 Civ. 0878, 2001 WL 986545 (S.D. N.Y. Aug. 28, 2001). Should the Supreme Court rule in accordance with the other circuits and overturn *Kiobel*, corporations worldwide could be exposed to liability in U.S. courts for actions that occurred anywhere around the globe and to which they may have no more than passively assented. Indeed, as the *Khulumani* dissent suggests, all they may be guilty of is simply selling their wares in a jurisdiction where the wrong government is in power and the company knew of the alleged wrongs committed by this government. In the world of political instability in underdeveloped nations, and at times in developing economies, this is a bar that is not set particularly high.

Keywords: litigation, business torts, Alien Tort Claims Act, corporate personhood, international law

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Evidentiary Challenges to Documents for Trial

By Zachary G. Newman and Anthony Ellis – May 8, 2012

With trials becoming increasingly rare, trial advocacy skills routinely need to be sharpened. While trial advocacy and continuing legal education classes can be valuable, one area of trial practice in which lawyers should constantly refresh themselves is analyzing documents for admissibility and other evidentiary pitfalls and objections.

Many lawyers seem to overlook the importance of addressing evidentiary issues from the outset of the case and miss opportunities during pretrial proceedings to lay the groundwork for or build defenses against documentary evidence well in advance of trial. At trial, information needs to be processed in real time, and objections must be assessed in split seconds. A key objection could prove critical to the case, and a misplaced objection could result in embarrassment before the jury or an admission of a weakness.

The foundation for a solid evidentiary challenge begins with an understanding of the documents that are likely to be introduced at trial. To be ready to object to or defend this evidence at key moments, attorneys must analyze the documents as early as possible.

Authentication and the Best-Evidence Rule

The power of documentary evidence in either disproving or establishing a claim is undeniable, and many jurors, when polled, will admit that, if they see a document presented as evidence, they automatically assume and accept that it is authentic and reliable. In fact, numerous famous cases have been lost or won on a single email. For example, the recent scandal plaguing Rupert Murdoch's son, James Murdoch, and Fox News generally has come down to whether Murdoch did or did not scroll down to review an email he received. This preconception requires counsel to perform a rigorous document review during the discovery phase.

While it is often simple to confirm a document's authenticity, it is advisable to ensure every relevant document's authenticity well before summary-judgment motions are due or the trial is scheduled. In federal court, the analysis begins with the instructions contained in Article IX of the Federal Rules of Evidence, which governs the authentication or identification of evidence.

Under Fed. R. Evid. 901, a proponent must "produce evidence sufficient to support a finding that the item is what the proponent claims it is." Rule 901(b) sets forth an extensive list of examples of ways to authenticate documents. For instance, a witness can authenticate a document by testifying that it is what it is claimed to be. If the document is a handwritten document, then the witness may authenticate the handwriting, provided the witness is not basing his or her familiarity on information acquired for the litigation. Even expert testimony can be used to authenticate documents.

When faced with documents lacking visible authentication markers such as corporate letterhead, an examination should be conducted with the appropriate witness as to the genuineness of the

document. Issues concerning the authenticity of documents can also be addressed in interrogatories or requests to admit. Often, simple questions such as "How do you know that?" or "Do you personally know that?" during depositions reveal critical information as to the witness's base of knowledge. Attorneys should consider maintaining spreadsheets that set forth each exhibit, identify its method of authentication, and list any evidentiary objections that may arise.

Certain documents are self-authenticating, such as domestic public documents that are officially sealed and signed. Fed. R. Evid. 902(1). Domestic public documents not sealed but signed and certified may also be admissible under Rule 902(2). Foreign public documents may be self-authenticating as well, provided the document is signed or attested to by a person who is authorized by the foreign country and the document is accompanied with a final certification in accordance with Rule 902(3). This process can be time consuming and should be implemented early during the discovery phase, especially given that adversaries are afforded a reasonable opportunity to investigate the document's authenticity and accuracy. Rule 902 enumerates many other self-authenticating documents, such as official publications, newspapers, periodicals, trade inscriptions, commercial paper, and certified records of a regularly conducted activity.

Often, lawyers attempt to introduce the contents of certain documents through oral testimony and run afoul of what is known as the best-evidence rule. Under this rule:

> [A] party seeking to prove the "content" of a writing must introduce the "original" or a "duplicate" of the original, unless it is established that (1) all originals have been lost or destroyed (absent bad faith by the proponent); (2) the original cannot be obtained; (3) the original is in the possession of an opposing party who refuses to produce it; or (4) the writing is not closely related to a controlling issue.

Fed. R. Evid. 1004.

The original writing, recording, or photograph is "required in order to prove its content unless [the Federal Rules of Evidence] or a federal statute provides otherwise." Fed. R. Evid. 1002. Events can still be proved by nondocumentary evidence, even though a written record of it was made. "If, however, the event is sought to be proved by the written record, the rule applies." Fed. R. Evid. 1002 Notes of Advisory Committee on Proposed Rules. For example, an employee's salary can be proved without producing the written wage documents, but if the issue concerns whether the employee signed the back of his paycheck, the actual check will likely be required. Pierre R. Paradis, "The Celluloid Witness," 37 *U. Colo. L. Rev.* 235, 249–51 (1965). "On occasion, however, situations arise in which contents are sought to be proved. Copyright, defamation, and invasion of privacy by photograph or motion picture falls in this category." Fed. R. Evid 1002 Notes of Advisory Committee on Proposed Rules.

Under Fed. R. Evid. 1003, duplicates are admissible to the same extent as originals unless a "genuine question is raised about the original's authenticity or the circumstances make it unfair to admit the duplicate." Fed. R. Evid. 1003; *see, e.g.*, *Myrick v. United States*, 332 F.2d 279, 282

(5th Cir. 1964) (no error in admitting photostatic copies of checks instead of original microfilm in absence of suggestion to trial judge that photostats were incorrect); *Johns v. United States*, 323 F.2d 421 (5th Cir. 1963) (not error to admit concededly accurate tape recording made from original wire recording); *Sauget v. Johnston*, 315 F.2d 816 (9th Cir. 1963) (no error to admit copy of agreement when opponent had original and did not on appeal claim any discrepancy).

What if the originals are lost or destroyed through no fault of the offering party? Under Rule 1004, a party may introduce other evidence of the content of a writing, recording, or photograph if the original was lost or destroyed; the original cannot be obtained by any available judicial process; the party against whom the original would be offered had control of the original, was notified that the original would be offered, and failed to produce it at the trial; or the writing, recording, or photograph is not closely related to a controlling issue. Under Rule 1005, a copy of public records is admissible, provided the record is otherwise admissible and the copy is certified as correct in accordance with Rule 902(4) or is testified to be correct by a witness who has compared it with the original. Rule 1007 also permits the proponent to prove the content of a writing, recording, or photograph by the testimony of the party against whom the evidence is offered. In a jury trial, the jury determines in accordance with Rule 104(b) any issue about whether the asserted writing ever existed, another one produced at trial is the original, or other evidence of content accurately reflects the content.

Relevancy and Prejudice

Under Fed. R. Evid. 401, evidence is deemed relevant if it tends to make a fact more or less probable than it would be without the evidence and the fact is of consequence in determining the action. “Relevancy is not an inherent characteristic of any item of evidence but exists only as a relation between an item of evidence and a matter properly provable in the case. Does the item of evidence tend to prove the matter sought to be proved ?” Fed. R. Evid. 401 Notes of Advisory Committee on Rules.

Generally, all relevant evidence is admissible unless another “evidentiary rule or law provides otherwise.” *Pease v. Lycoming Engines*, 2012 U.S. Dist. LEXIS 6354, at *4 (M.D. Pa. Jan. 19, 2012) (citing Fed. R. Evid. 402; *Daubert v. Merrell Dow Pharms*., 509 U.S. 579, 587 (1993) (noting that the “[b]asic standard of relevance under the Federal Rules of Evidence is a liberal one.”)). Courts will exclude relevant evidence “if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.” Fed. R. Evid. 403.

However, exclusion is viewed as an extreme remedy, and many courts refrain from excluding evidence at the pretrial stage and defer the decision until trial and with the benefit of having the record fully developed. Fed. R. Evid. 403; *In re Paoli R.R. Yard PCB Litig.*, 916 F.2d 829, 859 (3d Cir. 1999). Should counsel have questions about the admissibility of any evidence, the best practice may be to file a motion in limine to address deficiencies in documents or test their admissibility at the time of trial.

Partial Documents and Out-of-Context Testimony
Counsel should be vigilant in determining whether a document being offered into evidence is a complete document and whether it would be advantageous to introduce the entire document. Often this situation arises when only excerpts of emails are introduced.

An adverse party has the right to require the introduction of any other part or any other writing or recorded statement "that in fairness ought to be considered at the same time." Fed. R. Evid. 106. This rule prevents parties from taking concepts or facts out of context, and the trial judge has considerable discretion in deciding whether the introduction of the balance of the document or other documents should be addressed on cross-examination or later in the trial.

Settlement Negotiations
Documents that reveal settlement negotiations are generally inadmissible to prove liability for, the invalidity of, or the amount of a disputed claim. Fed. R. Evid. 408(a). Nor can they be used to impeach through a prior inconsistent statement.

Settlement negotiations could be admitted, however, to show bias or prejudice, or to negate a contention of undue delay. Fed. R. Evid. 408(b). Thus, in one case, although the plaintiff was permitted to introduce the settlement negotiations to negate the defendant's laches defense, the plaintiff was not allowed to introduce the negotiations to negate an expected defense of the defendant until the record was more fully developed. *Pandora Jewelers 1995, Inc. v. Pandora Jewelry, LLC*, 2011 U.S. Dist. LEXIS 62969, at *32 (S.D. Fla. June 7, 2011).

Permissible Impeachment and Bias
Throughout the pretrial proceedings, lawyers must be watchful for documents that can be used to impeach trial witnesses or demonstrate bias. These types of documents may not even appear to be admissible at first, but they could be used to discredit or contradict testimony. This type of evidence becomes critical during cross-examinations.

For example, the general rule in most jurisdictions is that references to the wealth or poverty of a party are not permitted. *Brough v. Imperial Sterling Ltd*., 297 F.3d 1172, 1178 (11th Cir. 2002). However, evidence concerning a financial incentive in the outcome of an action could be admitted on cross-examination to show witness bias. *Crowe v. Bolduc*, 334 F.3d 124, 131–32 (1st Cir. 2003); *Pandora Jewelers*, 2011 U.S. Dist. LEXIS 62969, at *35. Thus, cross-examination usually will permit additional opportunities to admit documentary evidence or to use documents to impeach the witness, such as under Fed. R. Evid. 613. "When examining a witness about the witness's prior statement, a party need not show it or disclose its contents to the witness. But the party must, on request, show it or disclose its contents to an adverse party's attorney." Fed. R. Evid. 613(a).

Often, a litigant may be able to overcome an objection to extrinsic evidence merely by offering to permit the witness to explain away the prior inconsistent statement. "Extrinsic evidence of a witness's prior inconsistent statement is admissible only if the witness is given an opportunity to

explain or deny the statement and an adverse party is given an opportunity to examine the witness about it, or if justice so requires." Fed. R. Evid. 613(b). Notably, this rule does not apply to an opposing party's statement as an admission under Rule 801(d)(2).

Hearsay

Documents must also be carefully reviewed for hearsay pitfalls and objections. This analysis begins with Article VIII of the Federal Rules of Evidence. Hearsay is a statement that the declarant does not make while testifying at the current trial or hearing and a party offers in evidence to prove the truth of the matter asserted in the statement. Fed. R. Evid. 801. Rule 801(d) identifies two categories that are not hearsay. The first is a declarant witness's prior statement, provided the statement is inconsistent with the testimony and was given under penalty of perjury. The statement also can be consistent with the testimony but offered to rebut a charge that the declarant "recently fabricated it or acted from a recent improper influence or motive in so testifying." Fed. R. Evid. 801(d)(1)(B). An opponent's statement that is offered against the opponent and was made by the opponent or someone authorized to make the statement also is not hearsay. Fed. R. Evid. 801(d)(2).

Counsel should evaluate each document and all expected testimony for hearsay challenges. This evaluation begins with the 23 exceptions to the hearsay rule set forth in Fed. R. Evid. 803, which includes present sense impressions, excited utterances, and then-existing mental or physical conditions. The most common exceptions utilized in business litigation are recorded recollection, business records, public records, and reputation concerning character. In addition, counsel can always resort to the residual exception contained in Fed. R. Evid. 807, which allows a trial court to admit hearsay if the statement has "equivalent circumstantial guarantees of trustworthiness," is offered as evidence of a material fact, is more probative on the point for which it is offered than any other evidence the proponent could obtain through reasonable efforts, and admitting the statement serves the purposes of the Rules of Evidence and the interests of justice. Most courts, however, construe the residual exception narrowly.

The business-records exception to hearsay is perhaps the most litigated exception in the business-litigation community. Under Fed. R. Evid. 803(6), hearsay is admitted if it can be established as a record or a regularly conducted activity. This is a record of an act, an event, a condition, an opinion, or a diagnosis, provided that five factors can be established. First, the record must have been made at or near the time by or from information transmitted by someone with knowledge. Second, the record must have been kept in the course of a regularly conducted business activity. Third, making the record had to be a regular practice of that activity. Fourth, all these conditions need to be shown by testimony of the custodian or another qualified witness or with approved certifications permitted by state statute or that complies with Rule 902(11). Finally, there must not be any indication of a lack of trustworthiness.

Business records should be subjected to heightened scrutiny during pretrial preparation and discovery. For example, some courts have precluded portions of business records that included an employee's conclusions or opinions, as they were beyond what was considered to be the

regularly conducted activity. *Pandora Jewelers*, 2011 U.S. Dist. LEXIS 62969, at *37; *Citizens Fin. Grp., Inc. v. Citizens Nat'l Bank of Evans City*, 383 F.3d 110, 121–22 (3d Cir. 2004) (upholding district-court ruling to exclude log entries that reflected "the thought process, conclusion, analysis or interpretation" of the employee who filled out the entry); *Vitek Sys., Inc. v. Abbott Labs*., 675 F.2d 190, 194 (8th Cir. 1982) (excluding handwritten memorandum of employee's meeting with customer as evidence of confusion because such evidence would elicit employee's evaluation of customer's thought process, and such testimony "does not fall within the present sense impression exception to the hearsay rule").

Certain entries of the business record may still be admissible, for example, if the business record itself or some other exception can be applied. *See, e.g*., *University of Ga. Athletic Ass'n v. Laite*, 756 F.2d 1535, 1546 (11th Cir. 1985) (admitting as evidence of actual confusion an affidavit from a professor who stated that he received inquiries in person or by telephone about an infringing mark); *Popular Bank of Fla. v. Banco Popular de Puerto Rico*, 9 F. Supp. 2d 1347, 1360 (S.D. Fla. 1998) (testimony by switchboard operator about misdirected calls due to confusion about trademark owner was admissible under "then-existing state of mind" hearsay exception).

With the proliferation of electronic evidence, care must particularly be applied to analyzing the applicability of the business-records exception. Some courts have found that emails sent casually as a substitute for a telephone call lacked the requisite regularity for the business-records exception to the hearsay rule. *See, e.g., In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex.*, 2012 U.S. Dist. LEXIS 16847, at *6–8 (E.D. La. Feb. 8, 2012).

Conclusion

Trial lawyers should approach document evaluation as a fluid, inexhaustible process. This mindset will allow lawyers to best leverage their clients' position through either the admission or exclusion of documentary evidence.

Keywords: litigation, business torts, pretrial practice, document evaluation, evidence, best-evidence rule

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Staying Private Avoids SEC, but Not All Regulation

By Matthew J. O'Hara – May 8, 2012

In January 2011, Facebook announced it would raise $500 million in capital while remaining a privately held company. Even though Facebook later decided to go public, this investment was widely viewed as a sign that major private companies believe they can raise large amounts of capital while remaining private. There is much debate over why such companies would remain private rather than go public.

Some suggest that Congress has over-regulated companies with publicly traded securities, making the costs of going public outweigh the tangible and intangible rewards. *See, e.g.,* Michael Helft, "Facebook Deal Offers Freedom From Scrutiny," *New York Times*, Jan. 3, 2011. But much of the discourse revolves around whether the Securities and Exchange Commission (SEC) will continue to allow major private companies like Facebook and Twitter to raise capital by going to a wide circle of well-heeled investors—such as a Saudi prince who recently invested $300 million in Twitter—without being subjected to regulatory oversight. Congress recently enacted a change to the Securities and Exchange Act of 1934 that increases the number of investors at which a company must register its securities with the SEC from 500 persons to either 2,000 persons or 500 persons who are not accredited investors. 15 U.S.C. § 78l(g).

The idea of private companies raising capital by granting equity stakes to outsiders is not limited to highly exceptional companies like Facebook and Twitter. Exchanges such as SecondMarket and SharesPost have been established to create a market in the shares of privately held companies, which are typically very illiquid investments. SecondMarket describes itself as "an SEC-regulated alternative trading system, registered broker dealer and member of FINRA, MSRB and SIPC" that specializes in "designing and implementing fully-customized liquidity programs for private companies," thus allowing private company shareholders to sell stock to "company-approved investors." Similarly, "SharesPost connects leading private companies with their current and future investors and provides the data, analysis and assistance they need to support their capital markets needs."

Largely neglected in this debate is the other side of the coin: whether private companies that raise large amounts of capital from outside investors and remain outside the SEC's reach are any better off regulated by state legislatures and state courts. Moreover, as courts apply such law to companies with larger networks of non-insider investors, there is also a question of whether disputes involving such companies will affect the private common-law regulatory scheme.

Much of the law regulating disputes brought by investors in private companies has developed in the context of small, closely held companies and is guided by state corporation statutes and court decisions. However, there are stark differences between major private companies and small, closely held companies. Major private companies seeking a broad base for raising capital may have a larger number of investors, institutional investors, and the potential for a secondary

market in investments through exchanges like the ones discussed above. In contrast, small, closely held companies often have a relatively small number of investors, many of whom are involved in management, and there is typically no liquid secondary market for equity or debt investments.

These differences highlight potential problems that may arise by applying state-law principles to this new vision of a major private company. This regulatory structure may pose more risks in some respects than being regulated by the SEC, and it may present problems that are no less significant than those faced by a public company. The risks and problems may grow when a major private company is faced with an aggressive litigation adversary pressing to stretch state laws to new limits. State law has already evolved to provide more protection to investors in closely held companies who do not have a ready means of exiting their investments. However, that trend may be affected by major private companies capitalized by hundreds of institutional investors if courts are called upon to regulate companies that do not fall within the realm of public regulation. Litigation against this new breed of company or its investors could have unintended consequences and significantly impact the existing private common-law regulatory scheme.

Why Stay Private?

The Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 have presented companies with myriad new reasons to remain private and avoid the expense and trouble of reporting in a public regulatory scheme. For example, Sarbanes-Oxley imposes accounting-related requirements on public companies by requiring them to develop effective internal controls for financial reporting and requiring auditors to attest to their opinion of the company's internal controls. 15 U.S.C. § 7262. Sarbanes-Oxley also established the Public Company Accounting Oversight Board to oversee the audit of public companies that are subject to the securities laws. 15 U.S.C. § 7211.

The Dodd-Frank Act is more sweeping in scope than Sarbanes-Oxley, and it implements requirements that reach previously unregulated financial activities and imposes new regulatory requirements on publicly traded companies. Two regulations of note include an enhanced "clawback" provision and "say on pay" requirements. Under the clawback provision, the CEO and CFO of any public company that had an accounting restatement as a result of misconduct must repay any bonuses or stock-based compensations and any profits made from trading in company stock during the preceding three-year period. 15 U.S.C. § 78j-4(b)(2). "Say on pay" requires public companies to ask their shareholders at least every three years whether they approve of the compensation plans for certain executives, and, at least every six years, companies must submit to shareholders the question of how often to have such a "say on pay" question on the proxy ballot. Further, in proxies for mergers and acquisitions, companies must also ask shareholders whether they approve of "golden parachute" arrangements for top executives of the company. 15 U.S.C. § 78n-1(a)-(b).

Even before Dodd-Frank, the number of public companies in the United States had declined notably. From 1997 to 2009, public companies traded on major exchanges in the United States fell from almost 9,000 to slightly more than 5,000. Alix Stuart, "Is Going Public Going Out of Style?" *CFO*, at 15 (May 2011). It is debatable whether this was a reaction to an already stiffer regulatory environment embodied by Sarbanes-Oxley or a sign of other economic forces at work. Public companies leave the markets in a number of ways, including going private, engaging in mergers and acquisitions, and delisting when stock prices or other attributes no longer meet the requirements of the listing exchange. Further, a dwindling number of IPOs has failed to replenish the number of publicly traded equity securities. *Id.* In this environment of greater regulation and less-receptive capital markets, it is no surprise that companies that can go public may elect not to or delay doing so. Although this may mitigate ongoing regulatory-related costs and avoid public scrutiny, it does not necessarily leave a more lenient privately regulated environment in its place.

No Public Regulation Does Not Mean No Regulation

Privately held companies have a different set of issues to consider, including audits, shareholder fiduciary duty restrictions, and shareholder remedy statutes. Typically, privately held companies are controlled by their owners and key managers. Such companies that can avoid the need to borrow often opt for unaudited financial statements because the costs of compiled or even reviewed financials are significantly less than audits, and the insiders feel they know the company and don't need an audit. However, private companies that wish to obtain equity capital infusions beyond a closely held base must forego this option, because outside investors are unlikely to invest without the level of assurance that an audit brings. Audits of private companies, while less demanding than those required by Sarbanes-Oxley with its required audits of internal controls, nevertheless add one layer of expense as a result of expanding the equity base in this manner.

Fiduciary duty among shareholders is an area where private-company regulation may raise as many concerns as public-company regulation. It is commonplace that corporate directors, officers, and employees owe fiduciary duties to the corporation and its shareholders. *See, e.g., Stamp v. Touche Ross & Co.*, 636 N.E.2d 616, 620 (Ill. App. Ct. 1993); *Alessi v. Beracha*, 849 A.2d 939, 950 (Del. Ch. 2004); *Small v. Fritz Co., Inc.*, 65 P.3d 1255, 1262 (Cal. 2003); *Morales v. Galeazzi*, 72 A.D.3d 765, 766 (N.Y. App. Div. 2010). However, in the typical public company with a large number of outside, passive investors, shareholders do not owe one another a fiduciary duty. In contrast, the exact opposite is true for shareholders in a private company. Several state courts have decided that shareholders in closely held corporations do owe one another fiduciary duties akin to those they would owe one another if they were partners. *See, e.g., Hagshenas v. Gaylord*, 557 N.E.2d 316, 321 (Ill. App. Ct. 1990), *Brodie v. Jordan*, 857 N.E.2d 1076, 1079 (Mass. 2006); *Brunetti v. Musallam*, 11 A.D.3d 280, 281 (N.Y. App. Div. 2004).

Illinois law provides fertile ground for analyzing the possible consequences of shareholder fiduciary duties in a Twitter-like company because the Model Business Corporation Act of 1950

was largely based on Illinois experience and the Illinois Business Corporation Act of 1933. *See Jackson v. Nicolai-Neppach Co.*, 348 P.2d 9, 14 (Ore. 1959). Over the years, the Model Business Corporation Act, in turn, has served as the basis for many states' corporate codes. In Illinois, this principle of shareholder fiduciary duties evolved from the rather groundbreaking opinion of the Illinois Appellate Court in 1990 in *Hagshenas*, *supra*. *Hagshenas* involved a prototypical closely held corporation—a small business with only three shareholders. 557 N.E.2dat 323. The court reasoned that the corporation effectively resembled a partnership, and, therefore, its shareholders should one another other the same fiduciary duties that partners do. *Id*. A subsequent Illinois opinion suggested drawing the line as to when shareholders owe fiduciary duties at whether a shareholder has the ability to "hinder, influence, or control the corporation." *Dowell v. Bitner*, 652 N.E.2d 1372, 1379 (Ill. App. Ct. 1995). The use of the word "hinder" makes this concept very elastic.

Though *Hagshenas* involved a small, closely held corporation, its reasoning is not necessarily limited to such a setting. One need only consider that there are many partnerships, including law firms and accounting firms, with hundreds of partners. If the principles of partnership law apply in such large partnerships, why should they not extend to a private corporation with up to 499 shareholders? In shareholder disputes, creative and aggressive plaintiff's lawyers could be expected to advance such an argument.

While not all states go as far in imputing partner-like obligations to shareholders in private companies, the implications for deciding to stay private remain great. Although public-company shareholders can treat one another like the strangers that they are, the shareholders of Twitter, or a private company with equity interests traded on a secondary market, may not have that luxury. To see why, one need only look to the types of duties that are imposed on partners or, by extension, on owners of business entities that the law views as tantamount to partnerships.

Under the Uniform Partnership Act, partners may not enter into a partnership agreement that eliminates the duty of loyalty, eliminates the obligation of good faith and fair dealing, or unreasonably reduces the duty of care. Uniform Partnership Act § 103(b) (1997). At the same time, however, partners may identify specific activities that are not violations of a partnership agreement "if not manifestly unreasonable." *Id.* Some courts have gone as far as to effectively invalidate provisions in partnership agreements that restrict fiduciary duties. *See, e.g., 1515 N. Wells, L.P. v. 1513 North Wells, LLC*, 913 N.E.2d 1, 11 (Ill. App. Ct. 2009) ("There is no authority 'for the proposition that there can be *a priori* waiver of fiduciary duties in a partnership'"); *BT-I v. Equitable Life Assurance Society of the U.S.*, 75 Cal. App. 4th 1406, 1411–12 (1999); *Konover Dev. Corp. v Zeller*, 635 A.2d 789 (Conn. 1994). Drawing the line between activities that do not violate partnership duties and those that do, even if expressly agreed otherwise in advance, is one fraught with peril, because fiduciary duty claims often arise in instances in which parties owe one another fiduciary duties and also have independent business activities of their own.

Consider a 400-shareholder private corporation in which many shareholders are investors with no management role in the company and no family ties inside the company structure. If there is no shareholder agreement to which all shareholders are a party (and such a requirement is at least a potential impediment to creating a secondary market for private-company stocks), these principles could wind up creating fiduciaries among strangers, to the extent that advocates successfully press courts to see such investors as having partner-like roles. If there is a shareholders' agreement, will a provision that "ownership interests in other businesses shall not be considered a breach of duty" be seen as "not manifestly unreasonable," or will it be considered unenforceable? If a shareholder buys a 1-percent stake in a communications business, can he or she be sued by other shareholders for competing with the corporation if that shareholder starts a closely held communications-related business of his or her own? Arguably, there is no principled reason why not, unless the courts are willing to recognize that a major private company that blurs the line between public and private is not subject to the same legal principles as the closely held corporation at issue in *Hagshenas*. At least in the context of a shareholder agreement that specifies types of activities that are not breaches of duty, increasing the size and passivity of an investment may weigh in favor of courts enforcing such agreements. Whether courts will do so remains to be seen, but this uncertainty serves as at least one reason for investors to consider whether they should invest in a major private company rather than invest in a public company with a similar market profile.

Remedies for Breach of Fiduciary Duty May Be Harsh

When one considers the remedies that are potentially available for a breach of fiduciary duty, public securities regulation may appear to be a more hospitable place to situate a company. For example, consider an executive that takes advantage of a business opportunity, arguably within the scope of the business, and then conceals that competition by causing certain transactions to be mischaracterized on the financial statements. Some draconian results are possible in the private-company arena. For example, where a fiduciary takes advantage of a corporate opportunity without presenting it to his or her corporation, or uses some assets of the company to develop his or her own business, that fiduciary may face the remedy of forfeiture of all income from the investment. *See* Restatement (Third) of Restitution & Unjust Enrichment § 51(4) (2011); *Seaboard Indus. Inc. v. Monaco*, 276 A.2d 305, 309 (Del. 1971); *Levy v. Markal Sales Corp.*, 643 N.E.2d 1206, 1215–17, 1219 (Ill. App. Ct. 1994). While the holding in *Levy*, for example, discussed the forfeiture of salary and benefits, creative litigants may press for the forfeiture of other income, such as dividends or other forms of profit that a shareholder may receive. In contrast, under the heightened compensation clawback provisions for public companies in the Dodd-Frank Act, if the financials must be restated when the wrongdoing comes to light, the executive faces the loss of incentive compensation in the past three years that was awarded as a result of the previous misstated earnings, as well as a possible SEC enforcement action seeking other remedies. But he or she probably does not risk the loss of all compensation during the period in which fiduciary duties were breached.

The concept of burden of proof highlights another feature of common-law fiduciary duties that may make regulation by private litigants more onerous than SEC regulation. When a fiduciary engages in self-dealing, the burden of proof shifts to the fiduciary to prove that the transaction was fair. *See, e.g., Bakalis v. Bressler*, 115 N.E.2d 323, 325, 328 (Ill. 1953); *Ostrowski v. Avery*, 703 A.2d 117, 121 (Conn. 2005); *Miller v. Miller*, 222 N.W.2d 71, 82 (Minn. 1974). In contrast, the burden of proof in a federal securities action on the same facts would be on the plaintiff, whether it is a private litigant or the SEC.

Private litigants can also invoke "shareholder remedies" statutes that are often found in state corporation acts. *See, e.g.*, 805 Ill Comp. Stat. 5/12.56; Wis. Stat. Ann. § 180.1833 (2002); Mo. Ann. Stat. §§ 351.850–351.865 (2001); Ga. Code Ann. §§ 14-2-940–14-2-943 (2011). These statutes invite private parties to seek judicial intervention in circumstances not set forth in the securities laws and provide courts with vast discretion to remedy such complaints. When a private corporation suffers from deadlock among its directors or its shareholders, when some shareholders engage in "oppressive" conduct toward other shareholders, or when the corporation's assets are being wasted, any shareholder may petition a court with jurisdiction over the parties for a panoply of potential relief. 805 Ill Comp. Stat. 5/12.56.

Once one of these preconditions is satisfied, a court may order the corporation to engage or rescind in particular actions, alter corporate bylaws, remove and appoint directors, remove officers, call for an accounting, appoint a custodian, order the payment of dividends, award damages, direct the purchase of the petitioning shareholder's shares by other shareholders or the company, or even dissolve the corporation. *Id.* In addition, these shareholders remedy statutes have generally become more friendly to individual minority shareholders. Several states eliminated the well-established concept of discounts for lack of marketability and lack of control and instead require the payment of "fair value" or effectively the shareholder's proportionate stake in the value of the entire business. *Id.; see also* Model Bus. Corp. Act § 13.01(4) (2005); *Pueblo Bancorp. v. Lindoe, Inc.*, 63 P.3d 353, 364-67 (Colo. 2003) (summarizing states' approaches to "fair value").

In contrast, while the SEC may investigate public companies, remedies exist only when there is a violation of the securities laws, not simply when decision-makers in a company are deadlocked or when some shareholders are being disadvantaged by others. 15 U.S.C. § 78u(a)(1). Even then, the SEC has a narrower range of remedies: injunctions against violations of the securities laws, the prohibition of violators from serving as directors or officers of public companies, disgorgement of personal gains derived from such violations, and civil penalties. *Id.* § 78u(d).

In a private action brought under the securities laws where a plaintiff seeks damages based on the movement of a company's stock price, damages are generally limited to the difference between what the shareholder received and the average price of the stock after the dissemination of corrective information to the market. 15 U.S.C. § 78u-4(e)(1). Private securities plaintiffs suing over public securities-law violations must also jump through a number of higher-than-ordinary hoops, including very strict pleading requirements concerning both alleged misleading

statements and defendants' states of mind, an automatic stay of discovery while a motion to dismiss is pending, and the burden of proving loss causation. 15 U.S.C. § 78u-4(b)(1)-(4). Given these procedural protections, directors and officers of a company that chooses to go public may actually face less risk in the event of litigation than one that remains subject to state private shareholder remedies statutes that lack such procedural hurdles.

Finally, companies that have the option of going public but that opt to remain private should consider that derivative actions may provide more benefit to shareholders in companies with fewer shareholders. Because a derivative action is brought in the name of and on behalf of the corporation, any recovery goes not to the nominal plaintiff directly, but rather to the corporation. *See, e.g.,* 805 Ill. Comp. Stat. 5/7.80; 8 Del. Code § 327; Delaware Chancery Court Rule 23.1. It is then up to the company or the court whether to distribute any proceeds pro rata to the shareholders. Logic dictates that where there are fewer shareholders to share in the recovery and a large company is at issue, derivative suits will appear more attractive than they would where shareholders are legion and own relatively minuscule stakes in the company.

Conclusion

A company that has the option of raising capital by issuing public securities faces difficult choices. By staying private, it may reduce the expenses associated with regulation and avoid making disclosures about itself to the public. However, the regulatory environment for private companies that broaden their circle of investors is fraught with risk and not necessarily more hospitable than regulation by the SEC. In addition, companies that choose to expand their capital base while staying private may affect the existing laws regulating private companies in ways that they and we cannot fully anticipate. If Facebook and Twitter are the harbingers of a trend rather than isolated events, the development of these issues could present a bumpy future for companies and shareholders alike.

Keywords: litigation, business torts, public securities, regulations, Securities and Exchange Commission

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YOUNG LAWYERS CORNER

E-Discovery: Getting to the Starting Gate

By James Worthington and Mor Wetzler – August 3, 2011

We live in an era of electronic discovery (e-discovery), as virtually all business information and communications are digital. Indeed, so much information is electronically stored that it is only a matter of time before e-discovery swallows all of discovery. How do you handle e-discovery at the start of a case? Prepare as much as possible, know the issues, and try to ask the right questions or at least ask lots of questions (and keep asking them throughout the discovery process).

Electronic What?
Electronically stored information (ESI) is "any information created, stored, or best utilized with computer technology of any type." This includes the more traditional "documents," such as word-processing files, spreadsheets, presentations, graphics, animations, images, emails, and instant messages (including attachments). It also includes audio, video, and audiovisual recordings, voicemails stored on databases, and structured/transactional data in a variety of forms. To consider just some of the more common examples, ESI can reside in networks; computers and computer systems; servers; archives; backup or disaster-recovery systems; compact discs; diskettes; hard drives; flash drives; tapes; printers; the Internet; and on BlackBerry devices (and other PDAs), handheld wireless devices, cellular telephones, pagers, fax machines, and voicemail systems. The list of ESI can go on virtually endlessly and seemingly grows more complex with every new development; cloud computing is only the latest in a long line of technologies that have added complexity to the litigator facing e-discovery challenges.

Why Does the "E" Matter So Much?
As in discovery more broadly, e-discovery issues fundamentally involve the process of locating, reviewing, and producing non-privileged materials that are responsive to discovery requests. But, electronically stored information poses challenges beyond traditional discovery. ESI can be voluminous and difficult to locate; it also frequently includes metadata, which is information about a document or file that the computer stores but that may not be accessible to the ordinary user. In addition, ESI easily is modified or deleted, and information systems, including systems that frequently are automated and can modify, delete, and overwrite it (absent timely intervention). Moreover, ESI's dynamic character easily can lead to the pitfalls of spoliation, which is the inadvertent or intentional destruction of relevant evidence after a duty to preserve it has attached. Spoliation is a rapidly developing area of law that is of vital and growing significance to judges and parties. Cases can be won and lost based on preservation, collection, and production failures. E-discovery sanctions motions can complicate a case and can reach not only parties but also their outside and in-house counsel. The costs of e-discovery can be

enormous, particularly at the stage when ESI must be processed, loaded onto a review tool, reviewed, and produced. However, proper and timely analysis and an understanding of the constantly developing technologies and methodologies can reduce or mitigate many of these costs and risks.

Is It All Bad?

Not necessarily. ESI can be easier to store, produce, review, and use than traditional non-digital forms of data storage. For example, "boxes" of documents can be stored online, retrieved with a few keystrokes, and produced on a single ROM (read-only memory) device such as a DVD or a hard drive or even uploaded to an online depository. Large volumes of material can be searched for concepts or keywords, and archived data can be tabulated, modeled, or analyzed. Unlike paper documents, ESI is far more persistent; for example, drafts of documents and other temporary materials that in the past may have been shredded or destroyed are now routinely preserved. For better or for worse, even ostensibly "deleted" ESI can linger in the form of backup tapes; archives; removable media; erased and fragmented data; metadata; and other such spectral forms. All of this can add up to a more complex but (in the right circumstances) arguably richer data environment for the litigator.

Getting a Handle

Early on in litigation or investigation, it is critical to analyze your client's data. You should have an understanding of what it is; who created it; how it is structured; where and how it is stored; and analyze potentially difficult data sources before they cause problems down the road. At the very outset, you will want to analyze preservation issues; you should evaluate the universe of data and documents that your client is under a duty to preserve and take appropriate measures. You also should identify key documents and subject matters, key players (both for the client and the other side), and any other information that will assist you in targeting your discovery efforts. Particularly, if electronic keyword filters will be employed, you should start analyzing early on the language that the key players (both friendly and opposition) use to discuss the critical subject matters at issue.

In litigation, you also will want to conduct an early offensive analysis to try to have an understanding of the data and documents you might expect (and want) from the other side. This frequently is conducted through analysis of your client's documents and communications with the opposing party (because you likely won't yet have access to discovery). This involves identifying the substantive topics that will be central to the matter, whether it is litigation or investigative. In addition, you should identify key variables that likely are to define the scope of discovery, including subject matters and/or custodians. This picture likely is to evolve as the case progresses, but early analysis is crucial.

As you develop your preliminary understanding (both offensive and defensive) of relevant data sources and types, you should consider the likely magnitude of the e-discovery effort for your client and for the opposing party. Projects of different scales can demand very different solutions. Identify your key custodians and data sources, and analyze the outer boundary limits to

the universe of potentially (or marginally) relevant custodians, databases, and repositories of standalone documents such as shared drives. Consider the point at which discovery costs will become disproportionate to the scale of the matter, and develop arguments (preferably supported by quantitative measures) to support your view as to the reasonable limits to discovery.

Initial Conference and E-Discovery Agreements

Much of the preparation listed above will assist parties in the initial conference and discovery meet-and-confer sessions. Depending on the jurisdiction, parties may have to disclose early on sources of ESI, custodians, and their plans with respect to ESI production from the other party. At the conference, parties should try to agree on various e-discovery topics, such as the scope of e-discovery (time periods, custodians, sources of standalone data, and metadata are frequent issues for discussion); the process for identifying, reviewing, and producing responsive documents; and the form of electronic production (e.g., handling metadata and native production). Other issues to consider at this stage include whether to use filtering, manual review, or a combination of the two; what opportunities or duties that the parties will have to supplement or revise their agreed procedures as discovery progresses; and what will happen if privileged or trial-preparation materials are inadvertently disclosed (a subject that continues to require analysis and discussion between the parties, even with the passage of Federal Rule of Evidence 502). The specifics of filtering alone can occupy many rounds of negotiation in complex cases, and it is frequently advantageous to test early and often to support your positions regarding the appropriate and inappropriate approaches to discovery in the case.

Early agreement on these issues always is useful to clarify the parties' obligations, and it is frequently easiest to reach agreement before problems arise rather than after problems occur. In more complex cases, discussions between the parties likely will continue throughout the discovery process, and courts increasingly expect a level of communication between parties that would have been unusual in the era of paper discovery (*see, e.g.*, *William A. Gross Constr Assoc. v. Am. Manuf. Mut. Ins. Co.*, 256 F.R.D 134 (S.D.N.Y. Mar 19, 2009) ("This opinion should serve as a wake-up call to the bar of this District about the need for careful thought, quality control, testing and cooperation with opposing counsel in designing search terms or 'keywords' to be used to produce emails or other electronically stored information.") or the Sedona Conference Cooperation Proclamation.

Want More Information?

With the ever-increasing role of ESI in discovery, it is critical to stay informed. You should look into your jurisdiction's ESI guidelines and discovery rules, as many jurisdictions have become increasingly specific in the guidance that they provide to parties concerning e-discovery issues (*see, e.g.*, the Delaware Court of Chancery Guidelines for Preservation of ESI, or the District of Kansas's particularly detailed directives, which include a list of 50 suggested questions for the Rule 26(f) conference). Review existing case law, such as the *Zubulake* and *Pension Committee* decisions, and cases in your jurisdiction. *See, e.g.*, *Micron v. Rambus*, 2011 WL 1815975 (Fed. Cir. May 13, 2011) and a companion case, *Hynix v. Rambus*, 2011 WL 1815978 (Fed. Cir. May

13, 2011); *Zubulake v. UBS Warburg*, No. 02 Civ. 1243 (SAS), 2004 U.S. Dist. LEXIS 13574, 2004 WL 1620866 (S.D.N.Y. July 20, 2004) or the other *Zubulake* decisions; *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec.*, No. 05 Civ. 9016, 2010 U.S. Dist. LEXIS 4546, 2010 WL 184312 (S.D.N.Y. Jan. 15, 2010) (as amended May 28, 2010). Also, stay abreast of broader resources, such as materials published by the Sedona Conference.

Keywords: ESI, e-discovery, litigation, investigation, Sedona Conference

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NEWS & DEVELOPMENTS

Quilloin May Limit Companies' Risk of Class Actions

The U.S. Court of Appeals for the Third Circuit continues to follow the Supreme Court's "bold and clear" lead in favoring arbitration clauses over state laws prohibiting class-action waivers. In *T Mobility v. Concepcion*, the Supreme Court held that the Federal Arbitration Act's (FAA) broad mandate favoring arbitration agreements, which are typically construed to not permit class actions, trumped a California state law that prohibited class-action waivers in consumer agreements. In 2011, the Third Circuit followed *Concepcion* and struck down a similar New Jersey prohibition on class-action waivers in *Litman v. Cellco P'ship*. On March 14, 2012, the Third Circuit struck down another, similar law, this time in Pennsylvania, in *Quilloin v. Tenet HealthSystem Philadelphia, Inc.* [PDF], Case No. 11-1393 (3d Cir., Mar. 14, 2012). This trend proves valuable to companies seeking to avoid the expense of class-action litigation and adds a premium to arbitration clauses.

Keywords: litigation, business torts, class actions, class-action waivers, arbitration

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Appeals Court Sides with Plaintiff in Settlement Dispute

In *Greenleaf Arms Realty Trust I, LLC v. New Boston Fund, Inc.*, No. 10-P-2192, 81 Mass. App. Ct. 282, 2012 WL 472919 (Mass. App. Ct. Feb. 16, 2012), the appeals court reversed the superior court's dismissal of the plaintiff's claims against a real estate investment fund, finding that the plaintiffs had adequately pleaded fraud and breach of fiduciary duty.

Keywords: litigation, business torts, fiduciary duty, fraud

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