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## TABLE OF CONTENTS

**ARTICLES**

# Hot Topics and Recent Court Decisions in E-Discovery

By Zachary G. Newman – June 20, 2012

From in-house servers to hard drives to flash drives to cloud computing and remote servers, there is an astounding amount of storage repositories and devices available to conduct discovery. Information is not limited to computers or backup tapes any longer as material information is now stored on smart phones, tablets, laptops, blogs, and even social media. *See VOOM HD Holdings LLC v. EchoStar Satellite L.L.C.*, 93 A.D.3d 33, 42, 939 N.Y.S.2d 321 (N.Y. App. Div. 1st Dep't 2012).

The plethora of available electronically stored information (ESI) can be daunting, and courts are becoming increasingly progressive in granting discovery orders revolving around electronic information and even social media. *See, e.g.*, *People v. Malcom Harris*, 2012 N.Y.Slip Op. 22109, 2012 WL1381238 (N.Y. Crim. Ct. Apr. 20, 2012) (upholding the district attorney's subpoena on the Twitter account of the defendant alleged to have participated in a protest march). These decisions and the complexities of e-discovery have caused the process to be both unpredictable in terms of costs and difficult to balance with the amounts actually in dispute in the litigation.

### Advice and a Report Card

"Broad discovery is an important tool for the litigant. . . ." *WWP, Inc. v. Wounded Warriors Family Support, Inc.*, 628 F.3d 1032, 1039 (8th Cir. 2011) (citing Fed. R. Civ. P. 26(b)(1)). When used with electronic information, however, this tool has spawned expensive discovery quests that are dominating litigation budgets. E-discovery has evolved into a very expensive endeavor, spawning a cottage industry of products, technology, and vendors, all claiming superiority in proficiency and accuracy to search, collect, and produce ESI. But do clients care about the technology or the impact e-discovery is having on their business operations and litigation costs? The answer is a resounding yes.

We surveyed a number of in-house counsel in the banking, insurance, real estate, and investment industries to gauge their experiences and views toward e-discovery. Surprisingly, most of them reported being dissatisfied with the manner in which e-discovery is managed and the lack of sophistication at their outside law firms with respect to e-discovery. One reported that outside counsel generally fails to appreciate and understand the burden e-discovery places on the business, recommending that outside law firms should offer their in-house information technology staff whenever possible to ease the burden.

A general counsel in the banking industry responded that "most outside counsel could do a better job of managing e-discovery by understanding the systems and data stores of their clients, so that they can better advise in all phases of e-discovery." Our survey participants consistently recommend that outside lawyers should be more conversant in basic IT skills relating to their

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litigation-management systems and general principles concerning networks and data, as in-house counsel usually has, at a minimum, a basic understanding of these systems.

A senior litigation counsel at a global insurance company succinctly commented that "outside counsel [generally do not] understand how costly preserving or restoring backup tapes can be and often promises the court the delivery of documents on a schedule that is unrealistic." Counsel noted that the outside firms "need to be a little more proactive in understanding the client's 'pain points' and 'wish lists' when it comes to e-discovery and more forceful in arguing them." Our in-house counsel reminds outside lawyers that the business units do not "bill for time spent assisting Legal and outside counsel with discovery, so outside counsel need to think creatively sometimes to help streamline and facilitate [the e-discovery process]."

Outside firms also need to be acutely aware of the growing displeasure in-house counsel have with the rising costs of e-discovery and the inability to accurately budget those costs within the context of pending litigation. In fact, FTI just published a comprehensive survey based on interviews with 31 in-house counsel with e-discovery responsibilities, most of whom work at Fortune 1000 companies. The survey found that 94 percent of respondents found the cost of e-discovery "frustrating." *New Study Says Cost Is Most Frustrating Factor in E-Discovery*, InsideCounsel, Feb. 9, 2012.

Accordingly, outside firms are well advised to understand the impact of e-discovery on their business clients and to stay abreast of information technology and the constantly evolving state of the law concerning e-discovery.

**Recent Developments**

Courts are becoming increasingly sophisticated in addressing and resolving e-discovery disputes, which are yielding diverse and, in some instances, punitive results. Therefore, litigants must strive to avoid e-discovery failures, which can materially increase costs and potentially damage the client's credibility before the court. Discovery failures also may result in time-consuming motion practice that can result in cost-shifting rulings, adverse inferences, and sanctions.

Recent decisions suggest that litigants continue to fail to appreciate the seriousness and urgency of preserving e-discovery and imposing effective litigation holds. Companies and their counsel continue to fail to implement and monitor the protocols. This very issue caused Delta Airlines anguish in *In re Delta/AirTran Baggage Fee Antitrust Litig.*, 2012 U.S. Dist. LEXIS 13462, 9-10 (N.D. Ga. Feb. 3, 2012). The Georgia federal court imposed sanctions under FRCP Rules 26(g) and 37 after Delta failed to produce responsive ESI. Delta's failures stemmed from a failure to implement the litigation hold as several key emails were deleted due to regularly scheduled maintenance and backup-tape overwriting. Delta also was found to have exhibited poor collection protocols by failing to realize that several drives, which were preserved, were not made available to the adversary.

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The same transgression resulted in an adverse inference against the defendant in *VOOM HD Holdings LLC v. EchoStar Satellite L.L.C.*, 93 A.D.3d 33, 939 N.Y.S.2d 321, 327–28 (N.Y. App. Div. 1st Dep't 2012). EchoStar failed to implement a litigation hold as soon as it became reasonably likely that the parties were heading toward litigation, and EchoStar lost a series of material emails as a result of its routine deletion policy.The New York appellate court concluded that an adverse inference was warranted because "EchoStar's spoliation of electronic evidence was the result of gross negligence at the very least."

Failing to meet e-discovery obligations can result in a court order permitting the requesting party access to the recalcitrant party's ESI, thereby divesting counsel of control over its own discovery production. While courts are generally reluctant to give counsel the keys to the adversary's citadel, this remedy is being considered more often to address deficient preservation, collection, and production protocols.

In the recent decision, *Jensen v. eClinical Works, LLC*, 29 Mass. L. Rep. 380 (Mass. Super. Ct. Jan. 26, 2012), the court, apparently disgusted with the defendant's lack of candor and failure to disclose, allowed the plaintiff's discovery vendor to conduct an on-site visit to determine what should be searched for responsive information and shifted discovery costs to the defendant, despite the limited damages being sought. Although the defendant's affidavit had attested to full production, the plaintiff found a number of publicly available sources of information showing complaints about the performance of the software, and argued that there must have been additional documents associated with the performance problems that were not produced.

A failure to preserve ESI may also permit the requesting party to take detailed discovery about collection and preservation methods. In *Cannata v. Wyndham Worldwide Corp.*, 2011 U.S. Dist. LEXIS 133061 (D.Nev. Nov. 17, 2011), after a failed Rule 30(b)(6) deposition of Wyndham's director of corporate compliance regarding ESI, the court noted that the actual litigation hold itself was not discoverable, but then held that the details surrounding the litigation hold were indeed discoverable, and required Wyndham to disclose information surrounding the litigation hold, including who received the hold and what kinds and categories of ESI were identified.

A request for a party to be given access to an adversary's ESI is not routine. *MPCA King of Spades v. T.E.C. 2 Broad. Inc.*, No. 1:11cv00080, 2012 U.S. Dist. LEXIS 50162 (W.D. Va. Apr. 10, 2012). The *MPCA* court noted that the request was appropriately made given "defendants' purposeful failure to retain" information "in an easily accessible format, a failure that continued after the . . .  litigation and after specific discovery requests for the information [are] discarded." *See also Diepenhorst v. City of Battle Creek*, 2006 U.S. Dist. LEXIS 48551, 2006 WL 1851243, at *3 (W.D. Mich. June 30, 2006) (imaging of an opponent's computer hard drive is not to be routinely granted under Fed. R. Civ. P. 34, but may be justified if the court finds inadequate production responses or deleted relevant material).

**What Is Counsel's Obligation?**
A number of recent decisions have focused on the counsel's responsibility when complying with

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e-discovery demands. The issue is whether counsel's delegation to its client to preserve, assemble, and collect ESI satisfies counsel's ethical and professional responsibilities. In *Auriga Capital Corp. v. Gatz Properties, LLC,* C.A. No. 4390-CS, 2012 Del. Ch. LEXIS 19, 2012 WL 361677 (Del. Ch. Jan. 27, 2012), Chancellor Leo Strine Jr. condemned counsel for allowing the defendant to copy his own hard drive, seemingly suggesting that counsel may not rely entirely on his client to perform the data collection.

Firms have to be especially careful about preserving their own data as well should they be called upon later to produce the information. This is what occurred in *FDIC v. Malik*, 2012 U.S. Dist. LEXIS 41178 (E.D.N.Y. Mar. 26, 2012), where a New York federal court found that a bank's former lawyers had an ethical obligation and a legal duty to preserve certain ESI relating to their prior representation when the law firm could only produce some emails concerning many loans it had documented. The court noted that the law firm had an affirmative duty to preserve the emails regarding loans the law firm worked on for the bank based on applicable professional-responsibility rules and attorney-ethics opinions. While the underlying claims in *Malik* revolved around legal malpractice, it will be interesting to see if other courts begin to hold counsel responsible for discovery failures that occurred at the client level.

Many courts enable the process by requiring e-discovery coordinators to be appointed "to promote communication and cooperation between the parties." *In re Porsche Cars N. Am., Inc. Plastic Coolant Tubes Prods. Liab. Litig.*, 2012 U.S. Dist. LEXIS 7999 (S.D. Ohio Jan. 24, 2012) (citing the N.D. Ohio Local Rule App. K Default Standard for Discovery of Electronically Stored Information). The Ohio federal court specifically noted, however, that notwithstanding the appointment of the discovery coordinators, the attorneys at "all times" will be "responsible for responding to e-discovery requests." *Id*. at *18.

It is thus incumbent upon outside counsel to be vigilant and diligent in reminding their clients as to the necessity of preserving critical ESI, as parties continue to run afoul of preservation rules, invoking the court's ire and sanction powers. *See, e.g*., *Micron Tech., Inc. v. Rambus Inc.*, 645 F.3d 1311, 1320 (Fed. Cir. 2011) (noting that if the district court concludes after analysis of all of the relevant factors that there was "bad faith and prejudice, the record evidence may indeed justify a dispositive sanction").

**Beware of Search-Protocol Pitfalls**

Devising an agreed-upon search protocol is critical to a successful e-discovery process. Counsel should meet and confer early in the discovery process to negotiate acceptable search terms, custodian lists, and the temporal limits of the search. When a dispute arises, the parties can turn to the court for guidance.

Failing to raise protocol issues to the court promptly can result in preclusion. For example, in *In re Nat'l Ass'n of Music Merchs., Musical Instr. and Equip. Antitrust Litig.*, 2011 U.S. Dist. LEXIS 145804 (S.D.Ca. Dec. 19, 2011), the plaintiff sought to compel the defendant to run document searches containing abbreviations and acronyms for agreed-upon search terms and

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concepts. The plaintiff argued that the defendant, after producing an initial round of e-discovery, should be compelled to identify abbreviations or acronyms commonly used within the defendant company, and assuming that abbreviations and acronyms were used, the defendant should be ordered to re-run its search and produce new responsive documents.

The court disagreed with the plaintiff's position, finding that the plaintiff had ample opportunity to obtain discovery regarding abbreviations and acronyms, and the burden and expense to the defendants to comply outweighed its likely benefit. The court also acknowledged that the defendants already searched and produced a significant number of documents, thereby incurring a significant expense. The new search terms would require the defendants to review tens of thousands of additional documents that would likely only yield a "very small number of additional responsive documents." The court did conclude that if the plaintiff chose to bear the costs for the discovery, the court would order the discovery.

Ineffective search protocols also can be a hazard for litigants. In *Green v. Blitz U.S.A., Inc*, No. 2:07-CV-372 (TJW), 2011 U.S. Dist. LEXIS 20353 (E.D. Tex. Mar. 1, 2011), the court swiftly issued sanctions against the defendant for failing to produce key emails regarding the subject flame arrester because it failed to do a simple search for "flame arrester," which would have found relevant emails regarding a key issue in the products-liability litigation. The defendant shockingly placed an employee in charge of searching for and collecting documents for the litigation, who admitted that he was basically computer illiterate. Here, the court found a willful intent to destroy evidence and awarded sanctions involving a $250,000 payment to the plaintiff for the prejudice that occurred from the defendant's discovery violations and conditionally awarded another $500,000 if the defendant did not produce the court's decision to every plaintiff in every lawsuit it was defending or had defended in the past two years. The defendant was even ordered to file the court's decision with its first pleading or filing in every future litigation for the next five years.

Thus, parties are well advised to work together to devise acceptable search parameters at the outset of discovery, and avoid tackling issues late in the discovery stage. *See, e.g., McGrath v. United States*, 2012 U.S. Claims LEXIS 98 (Fed. Cl. Mar. 6, 2012) (each requesting party limited to a total of 10 search terms per custodian per party, but allowing the parties to modify the limit without court leave); *Remark Elec. Corp. v. Manshul Constr. Corp.*, 242 A.D.2d 694, 695, 662 N.Y.S.2d 592, 593 (N.Y. App. Div., 2d Dep't 1997) (denying a motion to compel discovery because the movant waited approximately 20 months before moving to compel); *Lee v. Granoff*, 2009 NY Slip Op 30749U, 2009 N.Y. Misc. LEXIS 4685, at *33 (N.Y. Sup. Ct. Kings Co. Mar. 30, 2009) (failure to move to compel within a reasonable time is a basis to deny the motion).

**Predictive Coding and Collection Tools**

According to a recent ALM eDiscovery Market Study, "survey respondents overwhelmingly identified review, processing and analysis as the top three most expensive segments" of e-discovery. "With over half of the ALM survey respondents claiming to spend more than

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$100,000 on [e-discovery] for each matter, effective budgeting in the areas of processing, review and analysis is a high priority, especially for serial litigants who must allocate budgets across multiple matters." *Daegis Offers Cost-predictability with eDiscovery Calculators*, MarketWatch, Apr. 14, 2012.

With e-discovery costs on the rise, technology companies are hard at work in deriving technology solutions to the assembly-and-collection process. The hesitancy in employing these technologies, however, is the uncertainty of whether a court will accept and endorse the technology.

In a ruling of first impression, U.S. Magistrate Judge Andrew Peck ruled that computer-assisted review known as predictive coding may be an acceptable way to search for relevant data provided the same quality-control standards are met that apply to any other type of document review. *Da Silva Moore v. Publicis Groupe & MSL Group*, 11 Civ. 1279, 2012 U.S. Dist. LEXIS 23350, at *27 (S.D.N.Y. Feb. 24, 2012), *adopt'd by Moore v. Publicis Groupe SA*, 2012 U.S. Dist. LEXIS 58742 (S.D.N.Y., Apr. 25, 2012) (approving parties' use of predictive coding to cull down three million electronic documents to those most relevant to reduce the cost of reviewing the documents).

Predictive coding uses "sophisticated algorithms to enable the computer to determine relevance, based on interaction with (*i.e.*, training by) a human reviewer." The court noted that "[j]udicial decisions have criticized specific keyword searches" and that in "too many cases . . . the way lawyers choose keywords is the equivalent of the child's game of 'Go Fish.'" Judge Peck, who had previously written on the subject of predictive coding, explained that "[c]omputer-assisted review appears to be better than the available alternatives, and thus should be used in appropriate cases."

> What the Bar should take away from this Opinion is that computer-assisted review is an available tool and should be seriously considered for use in large-data-volume cases where it may save the producing party (or both parties) significant amounts of legal fees in document review. Counsel no longer have to worry about being the "first" or "guinea pig" for judicial acceptance of computer-assisted review.

*Id.* at *27.

Predictive coding is not appropriate in every case, and even Judge Peck cautioned that appropriate and reliable processes must be designed and implemented. While predictive coding and numerous other existing and emerging technologies (a Google search for "electronic discovery collector" yields over 2.8 million results) can harvest a manageable and relevant group of electronic evidence, it is fairly debatable whether computer searches can or should substitute for the traditional, initial attorney review. Erika C. Birg, a partner at Nelson Mullins Riley & Scarborough in Atlanta, cautioned:

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> . . . [T]he algorithms cannot ultimately replace the human element, particularly the lawyers' responsibility to know the key facts and documents in play and to ensure a full and complete production. **Ultimately, lawyers will not be able to abdicate their role to machines.** Associates play a key role in ensuring that the team (in large cases) or the lead attorney (in smaller cases) has all the facts at their disposal. Additionally, predictive coding as of yet cannot, to my knowledge, address issues relating to multinational proceedings and multiple languages.

*Does Predictive Coding Spell Doom for Entry-Level Associates?*, Law Technology News, May 3, 2012, (emphasis added).

**Conclusion**

E-discovery is and will continue to be an evolving area of the law that all litigators must keep keenly aware of with respect to the trends, responsibilities, and technological advances. As our judicial system is demanding precision with respect to preservation, collection, and production of ESI, both outside counsel and in-house counsel must work in tandem to produce complete, efficient, and predictable solutions, designed to minimize risk and to refocus efforts on winning the case as opposed to drowning in discovery costs.

**Keywords:** litigation, corporate counsel, ESI, e-discovery, predictive code

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# CDOs: Bankruptcy-Remote, Not Bankruptcy-Proof

By Adam Lavine and Sunny Thompson – June 20, 2012

In a decision with significant implications for the distressed CDO (collateralized debt obligation) market, the U.S. Bankruptcy Court for the District of New Jersey has held that CDO issuers may, in fact, be debtors under the Bankruptcy Code. While the decision may come as a surprise to some investors, it serves as a reminder that there is a reason why these types of entities are characterized as "bankruptcy-remote" and not as "bankruptcy-proof."

A CDO is an investment-grade security backed by a pool of assets, such as bonds or loans. CDOs are uniquely structured to represent different types of debt and credit risk. The different types of debt are often referred to as "tranches" or "slices" and have different maturities and associated risks—the higher the risk, the higher the payout. Typically, a CDO issuer issues various tranches of securities in the form of notes, and a contract called an indenture governs both the terms of the notes, including the interest rate and maturity date, and the respective rights of the various tranches of noteholders.

In *In re Zais Investment Grade Limited VII*, 455 B.R. 839 (Bankr. D.N.J. 2011), a group of senior secured noteholders, led by Anchorage Capital Group, filed an involuntary-bankruptcy petition against Zais, a Cayman Islands-organized issuer of CDOs. Prior to filing, the senior noteholders had solicited votes on a prepackaged plan under which the collateralized obligations owned by Zais would be actively managed with an eye toward liquidation of the portfolio. The proceeds of the liquidation would go to the senior noteholders, thereby wiping out the more junior tranches of noteholders. The debtor, Zais, did not challenge the involuntary filing, and the bankruptcy court entered an order for relief.

The junior noteholders, however, were not happy by this turn of events. Although an event of default had occurred in March 2009 when the notes became severely under-collateralized, the indenture trustee had continued to hold the portfolio, collect proceeds from the securities, and make periodic distributions to the noteholders. Under the indenture, the trustee was required to hold the portfolio intact unless two-thirds of all noteholders (both senior and junior) directed a sale or liquidation of the securities. Given the two-thirds requirement, the junior noteholders could block any attempt by the senior noteholders to force the sale or liquidation of the portfolio.

Some professionals and investors working in the distressed CDO market have assumed that such indenture provisions would present an obstacle to liquidating a CDO—even in bankruptcy. The senior lenders thought otherwise; their plan was to use the prepackaged-plan process to bypass the indenture's consent requirements, set up two classes of creditors (senior and junior), obtain acceptance of the plan by the senior noteholders, and cram down the plan on the junior noteholders.

**The Junior Noteholders' Motion to Dismiss**

In response to the bankruptcy filing, a group of junior noteholders, led by Hildene Capital

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Management and Hildene Opportunities Master Fund, filed a motion asking the bankruptcy court to dismiss the Chapter 11 case or, alternatively, abstain from presiding over the case (even though no other proceeding with respect to Zais was pending before any other court). In the words of the bankruptcy judge, this set the stage for “tranche warfare.” Indeed, the court noted that the case “[r]eminds one of the line by Maj. T.J. “King” Kong (played by Slim Pickens) in *Dr. Strangelove*, ‘Well, boys, I reckon this is it—nuclear combat toe to toe with the Rooskies.’”

Zais’s junior noteholders argued that the court should dismiss the case or abstain from hearing it for the following reasons, among others:

a. The interests of creditors and the debtor would be better served by abstention under section 305(a)(1) of the Bankruptcy Code;
b. sufficient cause exists to dismiss the case under section 1112(b) of the Bankruptcy Code;
c. Zais is not an eligible debtor under section 109(a) of the Bankruptcy Code; and
d. the petitioning creditors were not eligible to file an involuntary petition under both section 303(b) of the Bankruptcy Code and the indenture itself.

As detailed below, the court held that none of these arguments had any merit, and thus it denied the junior noteholders’ motion to dismiss.

**The Decision**

*Abstention*
Section 305(a)(1) of the Bankruptcy Code provides that a court may dismiss a case or abstain from asserting jurisdiction over it if “the interests of creditors and the debtors would be better served by such dismissal.” Courts typically consider the following factors when determining whether to dismiss a case:

1. the economy and efficiency of administrating the case
2. whether another forum is available
3. whether federal proceedings are necessary
4. whether there is an alternative means of equitably distributing the assets
5. whether the debtor and creditors can do an out-of-court workout
6. whether a non-federal insolvency proceeding is far advanced, and
7. the purpose for which bankruptcy jurisdiction has been sought.

The court made short shrift of the junior noteholders’ arguments with respect to the first six factors. Specifically, the court noted that (i) there is no other forum capable of granting relief, (ii) there are no other proceedings pending, and (iii) there is no prospect for an out-of-court workout or settlement given the indenture’s requirement that any sale or disposition of assets meet with the supermajority approval of all noteholders.

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The court more carefully considered factor seven—the purpose for which bankruptcy jurisdiction has been sought. After all, as noted by the court, "[m]ovants' essential contention is that the petitioning creditors are trying to use the Bankruptcy Code to avoid the limitations of the indenture, and that is an improper purpose for seeking bankruptcy jurisdiction."

The court ultimately rejected the junior noteholders' argument that Anchorage's purpose in filing an involuntary petition was to improperly circumvent the indenture's restriction on the disposition of Zais's assets absent the supermajority approval of all noteholders. To support its conclusion, the court noted that "sections 365(a) and 1123(b)(2) of the Bankruptcy Code specifically permit the rejection of an executory contract," which indicates that certain circumstances may justify overriding a "burdensome contract." In this case, the court viewed the indenture as an example of such a "burdensome contract" because it prevented the collateralized securities from being actively managed for the benefit of noteholders. In addition, the court found that the true purpose behind the filing was to liquidate the assets of the debtor and that a liquidation is an appropriate purpose for a Chapter 11 plan if it maximizes the value of the estate.

*Cause*

Under section 1112(b) of the Bankruptcy Code, a court may dismiss a bankruptcy case for "cause" if it was filed in bad faith. Some courts have found bad faith where creditors have filed a petition merely to obtain a tactical litigation advantage. Relying on such cases, the junior noteholders argued that Anchorage filed the petition merely to obtain an advantage over other creditors by circumventing the indenture's restrictions on disposing of assets without the consent of a supermajority of noteholders.

In rejecting this argument, the court concluded that even if it dismissed the case, the junior noteholders likely would never receive any payments under the indenture. The court reached this conclusion because the indenture provides that once an event of default has occurred, senior noteholders must be paid in full before distributions are made to junior noteholders, and, in this case, the collateral securities are so severely distressed that the senior noteholders likely would not receive payment in full. Because senior noteholders would not be paid in full outside of bankruptcy, the junior noteholders would not receive distributions under the indenture even if the court dismissed the case. Thus, according to the bankruptcy court, the filing of the petition cannot disadvantage the junior noteholders because "[r]eceiving zero under the plan is no worse than getting nothing" outside of bankruptcy. More importantly, though, the bankruptcy court noted that the junior noteholders still had the right to challenge confirmation of the plan, and they could raise arguments about valuation of the portfolio in the context of objections to confirmation of the plan.

Courts may also dismiss a bankruptcy case on the basis of "bad faith" if the petition does not serve a valid bankruptcy purpose. As previously discussed, the court held that Anchorage's goal of avoiding the restrictions of the indenture did not constitute an impermissible bankruptcy purpose. (Indeed, although not noted by the bankruptcy court, isn't every prepackaged case filed to avoid the consent requirements under debt agreements?) The court ultimately concluded that

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"the petitioning creditors have shown good faith in their desire to realize the greatest present value of the Collateral Securities for the benefit of the [senior noteholders] without negatively impacting junior creditors who have no prospect of recovery under the status quo."

*Zais*

Another device used to keep CDO issuers out of bankruptcy involves structuring CDO issuers as foreign-registered special-purpose vehicles with no employees and no assets in the United States other than collateral held in trust for the benefit of noteholders. The court, however, held that this structure did not prevent Zais from being an eligible debtor under section 109(a) of the Bankruptcy Code. Zais satisfied the eligibility requirements of section 109(a) both because Zais has a place of business in the United States and because Zais has property in the United States.

With respect to having a place of business in the United States, the court held that the "major portion" of Zais's operations are performed in the United States, including services provided by the collateral manager, the collateral administrator, and the indenture trustee on behalf of Zais. According to the court, that these services were conducted by independent contractors and not employees of the debtor was irrelevant because "a person has a place of business in the United States if . . . business is conducted in the United States on the person's behalf." In reaching this conclusion, the court relied on *In re Petition of Brierley*, 145 B.R. 151, 161–62 (Bankr. S.D.N.Y. 1992), in which the Bankruptcy Court for the Southern District of New York found that an England-based debtor had a "place of business" in the United States, in part, because the debtor used an accountant in the United States who maintained the debtor's books and records.

With respect to whether Zais had property in the United States, the junior noteholders argued that neither the securities pledged as collateral nor certain cash collateral held in bank accounts in the United States could be considered property of the debtor because such property belonged to the indenture trustee, which held such property for the benefit of noteholders. The indenture trustee, however, submitted a declaration disclaiming any beneficial interest in the cash or securities held as collateral. The court rejected this argument and held that the collateral constituted property of the debtor. If not, imagine the implications for other debtors with secured creditors holding collateral "in trust" asserting that such collateral does not constitute property of the estate.

*Involuntary Provision*

Section 303(b) of the Bankruptcy Code provides an exclusive list of who may file an involuntary-bankruptcy petition. The senior noteholders (led by the Anchorage entities) filed their petition under section 303(b)(1), which permits three or more entities holding claims totaling at least $14,425 more than the value of any collateral securing the claims to file an involuntary petition. In other words, the petitioning creditors collectively have to hold unsecured claims of at least $14,425 to be considered eligible petitioning creditors. Although petitioning secured creditors holding recourse claims will often waive a part of their secured claim so that they collectively hold at least $14,425 in unsecured claims or may assert that the value of their collateral is such that they collectively hold deficiency claims in an amount equal to at least $14,425, courts are divided on the issue of whether the holder of a non-recourse secured claim

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may be considered an eligible petitioning creditor. In their motion to dismiss, the junior noteholders argued that the Anchorage entities were not qualified to file an involuntary petition under this section because the notes are non-recourse. In other words, they argued that the senior noteholders, as secured non-recourse creditors, could never have claims greater than the value of the collateral, and thus they were ineligible to file an involuntary petition under section 303(b)(1).

Without addressing the merits of the junior creditors' argument, the bankruptcy court held that the junior creditors could not challenge the qualifications of the petitioning creditors under section 303(b)(1). To support its holding, the court cited *In re QDN, LLC*, 363 F. App'x. 873, 875–76 (3d Cir. 2010), a Third Circuit case holding that a creditor does not have standing to contest an involuntary bankruptcy filing. According to the Third Circuit, only the debtor has standing to contest an involuntary petition, and, in this case, Zais never objected to the filing of the petition prior to the entry of the order for relief. Indeed, no party—not even the junior noteholders—objected to the entry of the order for relief.

In addition, the court held that certain clauses in the indenture, which expressly prohibited junior noteholders from filing an involuntary-bankruptcy petition, did not apply to the senior noteholders. Although many indentures purport to restrict *all* noteholders from commencing an involuntary petition, this was not the case in *Zais*. Therefore, it remains to be seen whether a court would enforce such contractual restrictions among creditors, especially if the creditors challenged the filing prior to the entry of the order for relief.

**The Settlement**

Following the court's decision on the motion to dismiss, the "tranche warfare" between the parties continued as the junior noteholders filed both an appeal and a competing plan of liquidation. Ultimately, however, the parties reached a settlement as a result of a court-supervised mediation process. The settlement provided the junior noteholders with a one-time payment of $4.375 million and was approved by the bankruptcy court along with the plan of liquidation. Under the plan, senior noteholders are expected to recover $152.5 million.

**The Big Picture**

While *Zais* may be the first example of a high-profile CDO issuer in Chapter 11, it is just one of many cases suggesting that involuntary-bankruptcy filings are on the rise—at least with respect to high-profile debtors. Amidst such an environment, in-house counsel should always keep the risk of an involuntary filing in mind, for even "bankruptcy-remote" entities seem to be finding their way into Chapter 11.

**Keywords:** litigation, corporate counsel, collateralized debt obligations, CDOs, bankruptcy remote entities, intercreditor agreements, indentures

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# In-House Litigator Spotlight

By Editors – June 20, 2012

Denise Zamore is associate general counsel at UnitedHealthcare where her responsibilities include managing litigation arising in the Northeast (Virginia to Maine). Denise graduated from Georgetown, obtained her J.D. from Columbia, and completed a two-year clerkship in the Southern District of Florida. She worked in private practice for 10 years before joining UnitedHealthcare. The Corporate Counsel Committee editors recently sat down with her to talk about her in-house practice.

**Q: Why did you make the transition to practicing in-house?**
A: After spending 10 years litigating complex corporate matters, I wanted to get involved on the business side from the pre-dispute ground-floor perspective. I hoped that my move in-house would give me the opportunity to learn the business while using my knowledge and experience to implement changes that would help the company avoid future disputes.

**Q: What are the challenges of being in-house?**
A: Process. At a law firm, decisions can often be made immediately by one partner or a small group of partners. A corporation is made up of many parts, only one being its legal department. For these many parts to run smoothly, you need to have disciplined work processes in place. Processes, however, require time and—oftentimes—input from multiple people at multiple levels, especially in a field as highly regulated as healthcare. Therefore, many legal in-house decisions simply cannot be made in a split second.

Another challenge is demonstrating your value as a department. One very important aspect of a corporation's success is how well its shareholders do, i.e., profits. In-house lawyers—particularly litigators—usually don't bring in the money—we spend it. Therefore, we have to work especially hard at demonstrating how our work affects the bottom line.

**Q: What skills did you acquire in a law firm that helped you become a successful in-house lawyer?**
A: My work remains business-oriented and client-driven. I still perform a service to a clientele—I just happen to be employed by the same corporation as said clientele. While I am no longer responsible for building a book of business, succeeding in-house nevertheless requires building relationships, gaining intimate knowledge of my client's business and business objectives, and working collaboratively with others. As a commercial litigator, I often had to learn up a new industry or area of law when a new case came in. That flexibility made the UnitedHealthcare litigation learning curve easier to navigate.

Also, having practiced at a law firm, I understand both sides of the coin. There are certain misperceptions that outside lawyers have about in-house counsel (e.g., 9–5 days, playing golf in the afternoons) and misperceptions that some inside lawyers may have about outside counsel (e.g., they churn, a desire to go to trial without thoughts on how it might affect the business).

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Having seen things from both vantage points, I can say with certainty that these are far from the truth 99 percent of the time. But, my experience makes spotting that 1 percent a breeze.

I am also better equipped to manage staffing and billing issues. It's easy for me to discern whether we need four people on one conference call, whether we need more than one person to review a brief, or how long it should take to research a particular issue and draft a motion.

**Q: How is your approach as an in-house lawyer different from your approach in private practice?**
A: The goal of an in-house litigator has to be very different from that of an outside lawyer. I approach every new matter from all sides. My first instinct as an outside lawyer is to determine how I can win a case at trial. My first instinct as in-house counsel is to determine what the best outcome for the company and the business might be. That outcome might mean settling a case, it might mean changing a business process to avoid a repeat lawsuit, or it might mean litigating a case aggressively to send a message. Oftentimes, that is not a decision that can be made in a vacuum—it requires collaboration with my internal business partners.

**Q: Have you become more specialized?**
A: Yes, and sort of. My practice prior to moving in-house was complex commercial litigation. Since moving in-house, my work consists of healthcare litigation. And, because my responsibilities grow every day, so do my skills. At one point, I was responsible for our commercial litigation in the Northeast. I have also since been made responsible for our Medicare and Medicaid litigation. The beauty of my job is the ever-moving learning curve—it keeps things interesting, and I love it.

**Q: Do you have a particular management style?**
A: I am (as most esquires are) a Type A controlling personality. But, I've learned through experience that the best management style for me (both managing up and down) is one that is more hands-off. When I started this job, my manager and I agreed that he would let me learn my way, but he would always be available if I ever had any questions. I excelled because I learned so many things on my own instead of having them spoon-fed to me. I tend to manage the same way. Now that I have folks that report to me, I want them to know that I am confident in them and their abilities. I meet with them regularly to discuss their work and any issues they may have, and am always available offline to talk. But, I detest micromanagers, and I couldn't stand it if I became one myself.

At bottom, I am very supportive of my team and want them to excel. I often remind them of the Vidal Sassoon quote: "If you don't look good, we don't look good." I want my team to shine, because then we all shine.

**Q: What do you advise your internal clients about litigation prevention?**
A: Call me. Early. While my job is to manage litigation, I make myself available to listen in on calls or read over correspondence when things become thorny between us and another party.

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With some strategic collaboration, we are often able to work together to head off lawsuits before they arise.

Another lesson is learning from past experience. I think its key to debrief with the team after a significant matter has wrapped up to share lessons learned. For example, did the court find that contract provision ambiguous? Let's consider revising it in our other contracts.

**Q: What are your thoughts on diversity in the workplace and for outside counsel?**
A: I am a staunch advocate for diversity. I often tell my outside lawyers that, while I'll never tell them how to staff one of my cases, I like to see diverse folks on my cases. If you've got diverse folks employed at your firm, then I presume they must be excellent lawyers. Let's give them a chance to shine.

**Q: What advice would you give aspiring or newly minted in-house counsel?**
A: My little brother is beginning his career in-house this fall. I tell him often that his job is to add value, which might mean different things in different circumstances.

Listen to your business clients. Dig in and learn their business. It can only benefit you to learn what is going on in your organization beyond the legal department.

Your job is to help solve problems and help things run more smoothly while protecting the legal interest of the business—not to shut down the business. So, when they reach out to you for help or guidance, never just say no or "It can't be done." Try and work with them to find creative and strategic solutions to the issues that arise.

Your clients know what they want. Where it is possible, give it to them. Finding solutions to their legal and business problems will help you provide maximum value.

**Keywords:** litigation, corporate counsel, Zemore, UnitedHealthcare, private practice

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# The Trial of the Hidden Agenda: Part II

By T. Ray Guy – June 20, 2012

We continue Part II of this article where we left off in Part I, evaluating the concept of litigation conduct guided by a hidden motive. This next case example shows that hidden motives can be ascribed to defendants no less than plaintiffs.

**Proving a Hidden Agenda: The Technology Joint-Venture Case**
Several years ago we represented the U.S. subsidiary of a Japanese company in litigation in which the two parties to a technology joint venture blamed each other for its failure. At the time, virtually every new personal computer came equipped with a so-called floppy disk drive, and the most common means of transferring electronic files was via floppy disks, which could store slightly more than a megabyte of data on a magnetic-coated circular membrane encased within a hard plastic case. Higher-capacity methods of storing and transferring data were still in their infancy. Our client, a successful manufacturer of computer components (including disk drives) and other electronic parts, was interested in developing a new type of disk drive that would replace the standard, low-capacity floppy drive with a dual-function drive, which would read from and write to the ubiquitous floppy disks but also accommodate a new form of disk with several hundred times greater capacity. Our opponent was a U.S. company based a few miles from the courthouse; its primary line of business was manufacturing precision test equipment for electronic parts.

In investigating the potential project, our client had learned that the test-equipment manufacturer owned a license for some patented technology that appeared essential to the success of the drive. When our client sought a sublicense, the test-equipment manufacturer negotiated hard—insisting on a significant role in the project. As a result, our client entered into a joint venture with the test-equipment manufacturer, rather than obtain a license for the needed technology. The joint-venture agreement allocated to our client the responsibility to develop and manufacture the disk drive—a logical if ambitious extension of the expertise of a company with a track record of manufacturing precision disk drives and other data-storage devices. Our opponent, on the other hand, successfully negotiated for itself the responsibility for developing and manufacturing the "media"—the new high-capacity disk with same form factor as a standard floppy disk.

The venture failed. Litigation followed, with each party blaming the other for the failure. Our client actually filed the suit, seeking a declaratory judgment terminating the joint venture, but the opponent's multi-billion-dollar counterclaim effectively reversed the parties' positions and put us on the defensive. Our client claimed that our opponent had failed in its effort to develop satisfactory high-capacity disks, dooming the project. The opponent claimed that it *had* developed satisfactory media—working in concert with disk manufacturers—and that the project could have succeeded if our client had been willing to proceed into the production stage of the project. There was a third possibility: that neither party was at fault, but rather that the project was simply ahead of its time, and that technology did not exist to permit magnetically storing 500 megabytes of data on a size of disk usually used for storing a fraction of that amount.

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Each side had its trial theme (or themes). One of ours was that our opponent, the manufacturer of test equipment, was not qualified to fulfill its responsibility and essentially functioned as nothing more than a procurement department, outsourcing its duties—contacting a diskette manufacturer, providing it with the desired specifications for the high-capacity disk, and hoping that several weeks or months later the manufacturer would come back with an acceptable prototype. The theme had some support in the facts. Our opponent had been successful in selling low-volume, high-priced test instruments, but had never developed a product for mass production, let alone manufactured one. Lacking any capacity to design or produce diskettes, the opponent had no intention of doing so, and had in fact requested prototype disks from a succession of disk manufacturers with the intention of contracting for the manufacturing of the disks.

Our opponent's fine trial team, led by Allen Ruby of San Jose and Roy Bartlett of San Francisco, had its own theme. According to them, our client—again, the American subsidiary of a Japanese corporation—had never really wanted to join in the venture with their client, and ignored their client's real progress in developing the necessary magnetic storage media. Thus, in their version of the story, our client had gone through the motions, waiting for the venture to fail so that it could abandon its joint-venture partner and work directly with a diskette manufacturer—a Japanese one, at that—rather than with the opponent as a middleman. (Their theme was not true, by the way. It's my article. You'll have to call Allen or Roy for the other side of the story.)

The case settled after three weeks of trial, so we never knew which theme might have prevailed. Candidly, however, I have to say that our opponent's theme was the stronger one—because it included a hidden agenda, one that had several of the elements that make for a persuasive argument of an improper motive.

First, there was strong circumstantial support, objective and otherwise, for our client's supposed hidden agenda. Our client had a history of successful relationships with manufacturers of diskettes and other storage media—including, in particular, Japanese manufacturers. And during the course of the project, our client had, without question, become frustrated with the perceived lack of performance of its joint-venture partner. Our client had been reluctant to enter into the venture, and thereafter its executives and engineers had made clear their belief that the venture's chances for success would improve if our opponent allowed them to work directly with media manufacturers. Mid-project, they had attempted to negotiate a modification of the joint-venture agreement under which our client would assume responsibility for development of the media as well as the drive, and our opponent would receive a reduced royalty on the sale of disks if the venture succeeded. Finally, our client was the party that ended the project, declining to proceed with manufacturing and marketing when the opponent was urging that the parties do so.

In our view, the refusal to proceed was not motivated by a desire to force the opponent out of the venture; the real reason was that our client was convinced that the parties had not succeeded in developing the technology—whether drive, media, or both—to the point that would give the product launch a reasonable chance for success. Unlike the opponent, our client had substantial

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assets to protect from product-liability claims, and a reputation that could suffer damage from the public-relations debacle of a launch of an inferior product. But the opponent certainly had several pieces of circumstantial proof that would have supported a persuasive argument in its favor.

And there was one other factor that favored our opponent's theme: It played to the anticipated biases of the triers of fact. We had a Silicon Valley jury deciding a dispute between a Silicon Valley company and a Japan-based enterprise. At the time, American print and broadcast media were full of stories about trade deficits, Japanese ascendancy, declining U.S. technological capacity, protectionism, and the like. Studies show that when jurors (or other decision makers) are called upon to decide questions involving complex issues that they do not understand, they tend to make judgments based on past experiences, rules of thumb, or even personal biases. Our opponent's trial theme subtly played into a prevailing perception that Japan and Japanese companies were somehow competing unfairly with their U.S. counterparts.

As often happens, the mid-trial settlement meant that we never knew which trial theme would have prevailed—but I have to tip my hat to worthy adversaries for developing and using a powerful one that skillfully employed a hidden agenda.

**Ascertaining the Hidden Agenda**

As I've said, not every case involves a nefarious litigant whose actions are determined by unstated improper intentions. So how do you go about determining whether a concealed motive is driving your opponent's litigation strategy?

**1. Start early.** The search for case themes begins the moment you know that litigation is inevitable. Consideration of your opponent's possible hidden agenda should likewise begin early—so that you can use formal and informal discovery, as necessary, to gather any needed proof.

**2. Learn all you can about the opponent's business and history.** As with other aspects of trial preparation, there is no substitute for encyclopedic knowledge—here, of facts that are readily available to your opposing counsel but that will require creative research on your part.

**3. Put yourself in your opponent's shoes.** An essential step is adopting—temporarily, at least—the mindset of the other party. Devote some thought to your opponent's thought processes; incorporate a sort of retrospective game theory into your case evaluation. What might have motivated the opposing party to act as it did, other than naked greed or opportunism?

**4. Enlist your client in the search.** In most cases, your client will have known the opponent for months or years longer than you have, and will have lived with the dispute for a period of time before you were engaged for the litigation. Take advantage of your client's knowledge in seeking out any unstated motives driving your opponent's pre-suit behavior and litigation strategy. You'll almost certainly be planning to have brainstorming sessions with the client team to

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discuss trial themes; to these meetings or teleconferences, add an agenda item for consideration of the hidden agenda. In the Stoneville arbitration that I discussed in Part I of this article, our realization that the faithless distributor had been planning its exit from the relationship for years came during just such a strategy session in a windowless conference room in the client's office.

As in-house counsel, you have an advantage over me—a familiarity with your company's business arising out of having lived it every day. Nevertheless, the members of the business unit involved in the litigation probably have a level of knowledge that exceeds even your own. Take advantage of it.

**5. Use discovery to gather circumstantial proof of motive.** The information you can get from your opponent isn't limited to what will obviously be admissible at trial; you're entitled to inquire into—in the familiar words of Rule 26(b)(1) of the Federal Rules of Civil Procedure—". . . any nonprivileged matter that is relevant to any party's claim or defense . . ." including information "reasonably calculated to lead to the discovery of admissible evidence." In drafting your requests for production, and in preparing your deposition outlines, consider what documents might serve as objective evidence of motive or what answers from an unsuspecting witness could reveal unstated motives.

**The Presentation and Proof of the Hidden Agenda: Four Lessons**

The case history set forth above, as well as the two case examples in Part I of this article illustrate some of the issues to consider in asserting and proving that your opponent's conduct was motivated by an improper hidden agenda. There are others. Here's my list of five lessons for your consideration.

**1. Don't lose sight of the explicit elements of your claims or defenses.** For all of the utility of proving that your opponent acted pursuant to an unstated wrongful motivation, there are cautions to be observed. Again, the other party's intent is rarely an explicit issue in the case—an element of a cause of action or defense. Instead, it is usually employed to rebut, by inference, the opponent's claim or defense. Thus, you normally don't *have* to prove the hidden agenda to win. Don't let the desire to demonstrate improper motive overwhelm the methodical proof or disproof of actual elements of the claims or defenses.

**2. Don't assume an unnecessary burden of proof.** This caution also flows from the nature of the hidden agenda, which (like motive in a criminal case) is a useful but usually not essential part of your case. The trap to be avoided is creating, in the minds of jurors (or other trier of fact—judge or arbitrator) the impression that you can only prevail *if* they agree that the hidden agenda controlled your opponent's conduct—and they hold against your client because they aren't convinced of the existence of the improper implicit motive.

As you proffer the hidden agenda—in interim summation, closing argument, trial brief, or wherever—make it clear that while you believe it explains your opponent's conduct, it is not essential to your claim or defense, and that the evidence you have adduced requires a verdict or

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judgment or award in your favor, regardless of whether the trier of fact agrees with your view of the opponent's unstated motive.

**3. Marshall your circumstantial proof.** Again, the defining characteristic of a hidden agenda is that it is just that—*hidden*. The direct testimony of your opponent's motive or purpose remains under the control of your opponent and its counsel. They are not going to testify to the concealed improper purpose, and your witnesses won't be allowed to speculate as to what was in the mind of the opponent.

Accordingly, the proof of the hidden agenda will almost always be circumstantial. Often it will be objective and uncontested—like the records of purchases and sales of seed in our arbitration involving the Stoneville seed producer and distributor described in Part I. Sometimes it will involve testimony from your witnesses as to conduct of the opponent that is ambiguous but best explained in terms of your suggested motive. And you build your case by stacking the blocks of proof on each other, one by one, until the most logical inference points to the concealed purpose that you will argue controlled the opponent's actions.

**4. Determine the best time to raise the hidden agenda, and the best way to do so.** In some cases, you may choose to present the hidden agenda from the outset—in your opening statement, or even in your pretrial briefing. It thus becomes the theme (or one of the themes) to which your evidence is tied, one that helps the judge or jury or arbitrator remember your proof when it comes time to decide the case. In the seed producer/distributor arbitration, for example, we mentioned the hidden agenda in our opening statement at the hearing on the merits and referred to it at least indirectly in direct- and cross-examinations as well as in closing argument.

There are, however, reasons why you might choose to wait until closing argument, or at least some other late stage of the trial or arbitration, to bring up the concept that your opponent's conduct and litigating posture is best explained by an unstated improper purpose.

First, studies have repeatedly shown that we do a better job of remembering and hold more firmly to conclusions we have reached on our own, than we do to facts or arguments or points of view we have read or heard expressed by others. Jurors and judges and arbitrators are no different. If you withhold your explicit proffer of the hidden agenda until a late stage of the case, while in the meantime presenting your circumstantial building blocks of proof in an orderly fashion from the outset and throughout the case, you allow the decision maker to reach his or her own conclusion—the one you reached, months earlier, when you were evaluating the case and interviewing witnesses and reviewing documents. And your closing argument still gives you the opportunity to either emphasize the point or to present it to a trier of fact who hasn't managed to formulate it in his or her own mind.

Further, a juror or a judge or an arbitrator who has been given the task of deciding between competing contentions will be naturally inclined to view each side's arguments with skepticism until evidence has been presented that supports them. The contention that your opponent acted

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based on a concealed improper purpose may fall flat—may, in fact, be discounted as nothing more than shrill advocacy—if made in opening statement or other early stage of the presentation, before the jury or judge or arbitrator has had the opportunity to see and hear evidence that supports the argument.

In short: If your opponent's proper or improper purpose is not (as in the section 220 case described in Part I) an explicit element of a claim or defense, calling for an express finding, it may be best to develop the hidden agenda gradually, throughout the proceeding, instead of asserting it from the outset, and you may consider even holding it back for closing argument.

**Conclusion**

Trial lawyers routinely place their clients' economic livelihoods in the hands of jurors, judges, or arbitrators and ask them to render decisions based on a few days or hours of observation and evaluation. You increase your chances for success if you can make the decision makers comfortable that a determination in your client's favor is the fair and correct one. And one way to do that is to come from the opposite direction—with persuasive evidence that your opponent isn't to be trusted, and its evidence is not credible, because the opponent provoked the dispute by acting with unstated and improper motives. Hence the search for such motives and for methods of proving them.

Not every case involves a hidden agenda. But when one party's conduct arguably *is* driven by an unstated motive, the presentation of that hidden agenda at trial is a powerful tool of persuasion.

**Keywords:** litigation, corporate counsel, criminal litigation, motive, Proprietary Seed

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NEWS & DEVELOPMENTS

# Second Circuit Criticizes Lack of Deference to SEC Settlement Decision

The Second Circuit's recent decision in *Securities & Exchange Commission v. Citigroup Global Markets, Inc.*, 2012 WL 851807, --- F.3d --- (2d Cir. Mar 15, 2012) highlights the relevance of *Chevron*-style deference to policy judgments made by administrative agencies in choosing to settle enforcement actions.

The case arose from a proposed $285 million consent judgment in an SEC enforcement action regarding Citigroup's allegedly negligent misrepresentations in marketing of collateralized debt obligations (CDOs). The district court refused to approve the consent judgment, primarily because the settlement did not require an admission of liability by Citigroup. *U.S. Secs. and Exchange Comm'n v. Citigroup Global Mkts. Inc.*, No. 11 Civ 7387, 2011 WL 5903733, at *6 (S.D.N.Y. Nov. 28, 2011). Without establishment of the underlying facts either through a trial or an admission of liability, the district court opined, it was impossible to assess the fairness of the settlement. The decision therefore challenged the validity of the SEC's longstanding practice of allowing settlement without any admission of guilt by defendants.

The case came before the Second Circuit's motion panel by way of the SEC's motion to stay the district-court proceedings. The court held that the SEC and Citigroup were likely to succeed in overturning the district court's rejection of the settlement and consequently ordered the stay. In doing so, the court thoroughly chastised the district-court judge for his incursion into matters of agency discretion.

Though the Second Circuit found several problems with the district court's reasoning, it was most concerned that the district court had not deferred "to the S.E.C.'s judgment on wholly discretionary matters of policy," including the determination of whether the settlement would advance the public interest, and instead "imposed what it considered to be the best policy to enforce the securities laws." The court reasoned that an agency's decision to settle includes decisions about resource allocation and probable litigation outcome, which are generally not susceptible to judicial review under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)and *Heckler v. Chaney*, 470 U.S. 821 (1985). Accordingly, while the court declined to hold that a court can never review an agency's settlement decision, the court did conclude that "the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."

The Second Circuit also questioned the district court's view that the public interest could not be advanced by a "neither admit nor deny" settlement. The court "saw no basis to doubt" that the SEC considered the public interest in deciding to settle without forcing Citigroup to admit liability, especially in light of the fact that settlement may not have been possible without such a compromise.

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Although the Second Circuit will not hear oral argument on the meritsof the settlement until later this year,the court's order on the stay motion strongly indicates that the district court’s decision is likely to be overturned. More broadly, the Second Circuit’s decision evinces a hands-off approach to settlement decisions by administrative agencies, granting them potentially limitless discretion to determine what litigation outcomes will best serve the public interest. Though this approach has been criticized for providing too little oversight, it can be expected to work in the favor of companies involved in agency enforcement proceedings in the Second Circuit. A high level of deference will reduce defense costs and provide an increased level of certainty to litigants entering settlement negotiations with various agencies.

*—Katherine C. Wax, Perkins Coie LLP, Seattle, WA*

## Northrop Grumman Wins Committee's Pro Bono Award

Northrop Grumman Corp. is the 2012 winner of the Corporate Counsel Committee’s Annual Pro Bono Award. Northrop Grumman is a global corporation that is considered a leader in defense technology, providing critical technology to our armed services, including information technology, electronic systems, and technical services. Their commitment to the delivery of pro bono services benefits the members of our armed forces who have sacrificed quality of life serving our country. These beneficiaries of Northrop Grumman’s pro bono program are our silent heroes.

The delivery of pro bono services is more important today than it has been for many years, and challenges faced by members of our community are more complicated and wide-ranging. Economic factors and emerging technology have combined to create an environment for individuals who do not have the resources to get help with their personal and legal needs. The traditional role of a lawyer as pro bono counsel for someone involved in litigation has expanded to include providing advice and assistance ranging from how to identify and participate in assistance programs to how to apply for jobs. Corporate law departments face professional limitations when engaging in private litigation and are often challenged to find new and innovative ways to allow their members to provide pro bono services in a manner that does not interfere with their professional responsibilities as in-house counsel.

The Corporate Counsel Pro Bono Committee recognizes that there are many ways in which a corporate law department may perform pro bono legal services. Among the selection factors considered by the committee are:

- whether the law department’s program is a formal program
- whether there is a written pro bono policy adopted by corporate leadership

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- whether pro bono work is evaluated as a part of the regular performance review of in-house lawyers
- whether the pro bono program has its own budget
- whether the program enjoys high participation
- would learning about the program inspire others to start pro bono programs
- whether the pro bono program has a lasting impact on the community

The Operation IMPACT (Injured Military Pursuing Assisted Career Transition) program started by Northrop Grumman scored high marks on all factors. The program began in 2005 and identifies opportunities for wounded veterans to gain meaningful post-military employment. The program meets with external organizations to inform them about the program and to solicit candidates. It provides accommodations and training to help the veterans succeed in their post-military employment and facilitates post-hiring support for veterans and their families. Northrop Grumman has contacted more than 400 wounded veterans and hired more than 50 veterans through Operation IMPACT. The program has been identified as a "best practice" by the U.S. Department of Labor and the Department of Veteran Affairs.

In connection with Operation IMPACT, Northrop Grumman's Law Department has solicited and interviewed candidates for departmental positions. One of the individuals hired is Amanda Marin-Aceveto, whose fiancé (and now husband) Javier Torres returned home from a tour in Afghanistan. He suffered wounds in an ambush that resulted in him being told by doctors that it would be unlikely he would ever walk again. Through Operation IMPACT, Mrs. Marin, who had no formal legal experience, became employed by Northrop Grumman's Office of General Counsel as a paralegal.

In 2009, Northrop Grumman expanded its commitment to public service by creating the "Network of Champions." Through this, Northrop Grumman identifies and works with other companies who have a similar interest in assisting wounded veterans by creating job opportunities for them and their families. Over 65 companies have joined the network since it was started.

Attorneys in Northrop Grumman's legal department also participate in the Washington Metro Chapter of the American Corporate Counsel Association's "Street Law" program. The program is a pipeline that works with high-school students to promote knowledge of the legal system, the democratic process, and the rule of law. Volunteers teach classes at disadvantaged high schools and work with students on mock trials.

Northrop Grumman's attorneys also participate in a number of other formal and informal pro bono programs around the country, including the District of Columbia Bar Association's Pro

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Bono Program, which provides free legal services for indigent clients who are at risk of losing their homes or who are facing other legal challenges.

The Corporate Counsel Committee is pleased to recognize Northrop Grumman's Law Department for its dedicated delivery of pro bono services to benefit our nation's veterans, our nation's youth, and our indigent citizens who need legal services.

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## Third Circuit Narrowly Construes Discovery Cost-Shifting Statute

The Third Circuit recently issued an opinion to provide "definitive guidance" to district courts regarding the electronic-discovery charges taxable to an opposing party under 28 U.S.C. § 1920(4). In *Race Tires America, Inc. v. Hoosier Racing Tire Corp.*, No. 11-2316, 2012 WL 887593, --- F.3d --- (3d. Cir. Mar. 16, 2012), the court vacated most of the district court's $365,000 award of charges relating to vendor electronic-discovery fees. The court concluded that only costs regarding the "scanning of hard copy documents, the conversion of native files to TIFF, and the transfer of VHS tapes to DVD involved 'copying'" and, therefore, only these charges were recoverable under the express terms of the statute.

After granting the defendant's motion for summary judgment, the district court considered the defendant's bill of costs and concluded that the entire amounts charged by the electronic discovery vendors were taxable. These charges included activities involving: (1) the preservation and collection of electronically stored information (ESI); (2) processing the collected ESI; (3) keyword searching; (4) culling privileged material; (5) scanning and TIFF conversion; (6) optical-character-recognition conversion; and (7) conversion of videos from VHS to DVD format. The district court determined that the steps the vendors performed were the "electronic equivalent of exemplification and copying" and, therefore, were taxable to the opposing party. The district court went on to conclude that "the requirements and expertise necessary for production were an indispensible part of the discovery process" and that these charges were "necessarily incurred and reasonable" expenses.

On appeal, the Third Circuit considered whether the costs associated with electronic discovery were taxable to the opposing party as either "exemplification" or "the making of copies of any materials" under 28 U.S.C. § 1920(4). As a question of statutory construction, the court reviewed the district court's holding de novo.

The court determined that none of the electronic-discovery charges constituted "exemplification" because the vendor's work did not produce illustrative evidence or authenticate public records. Nor did the majority of charges fall under the "making of copies." Of the activities undertaken

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by the vendor, only the conversion of native files to TIFF, the scanning of documents to create digital images, and the conversion of VHS tapes to DVDs could be considered copying. The court refused to allow the costs associated with electronic discovery beyond that of copying materials. That the discovery services provided were highly technical and beyond the expertise of the attorneys did not impact whether the services were taxable under the statute. The court noted that unless parties elect to obtain a cost-shifting protective order, the courts are limited to shifting only the costs explicitly enumerated in 28 U.S.C. § 1920.

The court affirmed the taxation of approximately $30,000 in charges relating to scanning, and TIFF and DVD conversion without considering whether these charges were necessary or reasonable, finding that the question of the reasonable amount of costs taxable as copies "necessarily obtained" for the use in the case falls within the discretion of the district court.

While the opinion clarifies the costs chargeable in the Third Circuit, the extent to which electronic discovery is taxable to the opposing party is still unsettled in other jurisdictions and litigants may find many courts continuing to take a more liberal view of the charges included under 28 U.S.C. § 1920.

**Keywords:** litigation, corporate counsel, discovery costs, e-discovery, Third Circuit

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