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Project: *Corporate Counsel Part I (Unintended Consequences) – Law Firms*

A Hypothetical? – It Could Be Your Company!

You are the general counsel of International Consolidated. At 3:30 p.m. Monday, you get a call from a reporter who tells you that your company has just been sued by 50 people who purchased pencils manufactured by it. The reporter had just obtained a medical report that the yellow paint used on pencils when chewed causes injury. Specifically, middle-age males lose some of their hair and gain weight. Cases are filed in Madison County, Illinois, and West Virginia. The reporter has a 4 p.m. deadline to file his story.

Investor relations alerts you to the fact that your stock is down 15 percent on short selling following an analysts' briefing by plaintiffs' lawyers. You cobble together a statement to meet that 4 p.m. deadline. You haven't seen the complaint yet, but you are certain it is without merit and the statement reflects that. Then, you get another call. Your 10Q is due tomorrow.

By the time you filed the 10Q on Tuesday, you have seen the complaint. You then issue a new statement to the press that modifies Monday's statement. The new statement is a brief statement of the theory of the case, the fact that you intend to defend it vigorously and that you have no basis on which to quantify any potential loss. You then get inquiries from state attorneys general based on documents provided by plaintiffs' lawyers showing that you failed to warn the public and demanding immediate warnings.

The SEC complains that on Monday you thought this suit was without merit, but the 10Q filed on Tuesday did not contain that statement. Therefore, they want corrective disclosure and are threatening sanctions if the corrective disclosure is not forthcoming. Shareholder suits are filed hoping to capitalize if the securities regulators get a retraction and charging the directors with mismanaging the pencil distribution business.

A few months later, you have developed a good defense and you are persuaded that the plaintiffs can never prove the injury. However, two of the 15 studies you have done suggest that there could be a link. A number of the state attorneys general and the SEC tell you that you will be deemed non-cooperative unless you waive the attorney-client and work product privileges on all of your studies, reports of internal investigations and legal memoranda. Your outside counsel tells you that if you provide the information, the plaintiff's bar will have full access to all of your analyses of the strengths and weakness of your case. No doubt the newspapers will as well.

Outside counsel also insists that, at enormous expense, you no longer recycle any of your backup tapes and no longer destroy any documents until they all can be searched to discover if there are any e-mails or other documents that refer to pencils or financial disclosures of reserve calculations or decisions about what to disclose. An important and strategic merger that your corporation was considering is now unraveling as the other company gets concerned about your stock price and the potential liability. Plaintiffs come to you and offer to settle the matter for a mere $50 million.

What next? Can you extricate yourself and your client? See Index on page 35 for articles/interviews that can help.

Colin P. Smith

The Deck Is Stacked

The Editor interviews ***Colin P. Smith****, Partner, Holland & Knight LLP.*

Editor: What are your general reactions to the hypothetical on page 3?

Smith: It is an example of "the perfect storm," a scenario we have seen play out several times in recent years. The Ford Motor Company-Bridgestone/Firestone tire recall situation – in which I was involved – was a similar multifront crisis, and the diet drug litigation raised some of the same issues. Today we have Vioxx litigation and defibrillator recalls, and companies are faced with potential disaster far in excess of anything that an individual lawsuit may entail. This is a consequence of the involvement of the media, regulatory agencies, state attorneys general, even Congress. With the press as a catalyst, the storm comes to a head much more quickly than anyone could have imagined and, indeed, more quickly than

almost any company can react. Decisions must be made immediately, and very often those decisions have countervailing and irreconcilable tradeoffs. Something that might minimize a risk on one front, such as public relations, might increase it on another, such as litigation. Unless companies have crisis management plans in place, together with the resources to deal with these situations, they can be overwhelmed before they realize what is happening.

Editor: To what extent are discovery costs and risks driving settlement?

Smith: In certain situations discovery costs and risks can force settlement. Despite some positive changes in the Federal Rules of Civil Procedure, discovery is practiced in an unlimited fashion in many courts. Rather than exercise some form of control over discovery, most courts take the default position of permitting *any* requested discovery. While there has been some discovery cost shifting entertained recently, particularly in e-discovery, I think it is still the exception rather than the rule. At this point, it is incumbent on corporate defendants to be creative and develop their own defense strategies and economies. They are not likely to get much help from the courts.

Editor: Have discovery sanctions been a fertile ground for what could be termed as "blackmail?"

Smith: Absolutely. There are many plaintiffs' lawyers who have become specialists in tactical sanctions litigation. This kind of thing requires defendants to be on the lookout for these tactics from the beginning of any significant litigation. With careful planning, the defendant can be ready for this line of attack and, indeed, reveal it for what it is. Once the defendant falls behind, however, these tactics can drive the entire litigation and eventually the result. This is the reality today.

Editor: Do you agree with the proposition that an instruction that allows the jury to presume who was at fault will have significant importance for the defendant?

Smith: Certainly that can amount to the equivalent of the death penalty, but it is not a common risk. Bad inference jury instructions are far down the line with respect to sanctions that are commonly considered and awarded by courts. There are other sanctions that loom larger as potential risks, such as default, large monetary sanctions or evidence preclusion sanctions.

Editor: Why are punitive damages such a concern?

Smith: They are less of a concern since *State Farm v. Campbell,* which should eliminate some of the wildest aberrations. The problem lies in the unpredictability of punitive damages, and *that* is what drives settlement values. A number of studies, such as those conducted by the Rand Corporation, show that punitive damages are not much of an issue and that awards are commonly reduced or even reversed. *But,* any in-house litigation manager will tell you that those studies do not reflect the real decision-making process when a company faces a legitimate potential for a multiplier above compensatory damages. There is a significant risk premium and an attendant desire to settle and avoid that risk. Plaintiffs' lawyers know that and will continue to seek punitive damages whenever possible.

Editor: What about the hiring of plaintiffs' attorneys by regulators and prosecutors?

Smith: In my opinion, the trend towards empowering plaintiffs' lawyers to seek tort damages on behalf of government is the worst public policy mistake made in America over the last 30 years. Our government has unleashed the plaintiffs' bar to do through the tort system what our legislatures have declined to do. Most of us watched it happen in tobacco litigation without complaint because tobacco companies have been pretty unpopular in the public eye. This development, however, has created a monster. Today we see these law firms, fueled with the tobacco settlement money, looking for new targets. One of the problems is that the plaintiffs' bar is its own constituency and has little accountability. Their goal is to maximize monetary recovery regardless of collateral damage. In time, I believe we will recognize that this represents a foolish abdication of governmental responsibility. There is no single mechanism to address this situation, although clearly increasing the resources and staff of the law enforcement authorities is a necessary first step. This is beginning to happen. The increasing use of coordinated multistate attorneys general initiatives is certainly a better alternative than the plaintiffs' bar, and it is one with some accountability.

Editor: What concerns arise in the civil litigation context when the same events are the subject of a criminal investigation or grand jury investigation?

Smith: The biggest problem is that anyone who faces such a situation has to recognize that there may be no attorney-client privilege. Under the Department of Justice guidelines in the Thompson Memorandum, it is practically a requirement that a corporation facing a criminal investigation waive the attorney-client privilege to first obtain the possibility that a prosecution will not proceed or to achieve any practical relief in the sentencing phase of a prosecution. The result is that a corporation has to waive the privilege and thereby effectively deliver its most sensitive documents to opposing lawyers in the civil litigation. This is counter to the traditional notions of the sanctity of the attorney-client privilege and worse, can leave the corporation with a Hobson's choice between a crippling prosecution or crippling civil liability.

Please email the interviewee at colin.smith@hklaw.com with questions about this interview.