STRATEGIES AND TECHNIQUES FOR DEALING WITH THE STRIKE SUIT

APPROACHES TO WARD OFF DISASTER

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I. Introduction

> [Strike suits] represent everything Americans hate about our legal system -- professional plaintiffs, fishing expeditions with boilerplate accusations of fraud, contingency-fee lawyers who make a huge profit even when the case does not reach trial, and multimillion-dollar settlements that reward the lawyers and resemble legal blackmail.[1]

Strike suits are those actions that, because of the nuisance they create, possess a settlement value independent of their merits.[2] Strike suits come in a variety of flavors. The most common forms are shareholder class action suits and derivative actions, although consumer class actions are being filed with increasing regularity. The topic of strike suits is so broad that space does not permit a comprehensive discussion of all issues pertinent to handling them successfully. The purpose of this paper is to provide some practical guidance on avoiding and successfully handling strike suits.

II. Avoiding Strike Suits

To quote Mr. Miyiagi, the sage Japanese teacher from the movie The Karate Kid, "the best defense to a punch is not to be there." Strike suits should be avoided if at all possible. Many of them can be avoided if management and corporate counsel are sensitive to the types of factual scenarios that commonly lead to the filing of strike suits. When these situations arise, taking appropriate steps can reduce the risk of a strike suit being filed and create a record on which a successful defense can be based if such an action is filed. Scenarios that commonly spawn strike suits include the announcement of "bad news," *i.e.*, developments that disappoint Wall Street analysts' expectations; mergers and acquisitions, especially those in which the target attempts to fend off a hostile takeover; transactions among affiliated entities with significant minority shareholder interests; precipitous drops in the price of securities within a relatively short time of their issuance; and transactions with board members, among others.

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Once a situation is identified as having significant strike suit potential, steps can be taken both to minimize the risk of a strike suit being filed and to create a favorable record on which to litigate if one is filed. The "bad news" suit scenario provides a good example.

A. The "Bad News" Suit

Shareholder class action suits often follow a company's announcement of unexpected bad news, such as a failure to meet analysts' expectations or an adverse product development, *e.g.,* a new medication's poor performance in clinical trials. Such announcements may be followed by a significant drop in a company's stock.[3] Within hours of the announcement, the company may face multiple class action lawsuits commenced by plaintiffs with only small investments in the company's stock. Typically, the claims are brought under the anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, promulgated thereunder, although state statutory and common law theories also are used.

Plaintiffs usually claim that some group of defendants (the company and perhaps a subset of officers and/or directors) either knew -- or should have known -- about the bad news, and should have disclosed it to the market sooner. Alternatively, plaintiffs may allege that the defendants made a material misstatement in disclosures to the market, painting an unrealistically optimistic picture of the company or one of its new product's prospects. High-tech and high-growth companies, including those involved in pharmaceuticals, biotechnology and computers, are common targets of these suits based on the volatility of the stock of companies in those industries.[4] The allegations of "fraud" in the often hastily-drafted complaints may contain little, if any, factual support. Rather, these complaints may be based purely on "fraud-by-hindsight," *i.e.*, the fact that something bad happened means the defendants must have known that event would happen weeks or even months before. On such speculative pleading, the company may confront the exorbitant cost of defending a class action lawsuit, including its wide-ranging discovery.[5]

Many "bad news" suits are the consequence of earlier "forward-looking" announcements by the company or statements to analysts concerning future results that do not ultimately pan out. In the absence of the earlier forward-looking statement, there may well have been no duty to disclose the "bad news" when it occurred.[6] However, once an earlier forward-looking statement is made materially inaccurate by subsequent events, there is a duty to correct the earlier statement.[7] The risk of "bad news" strike suits can be reduced through a program of carefully monitoring the company's communications with the public and analysts and, where necessary, intervening as early as possible to correct misapprehensions that might exist in the marketplace, especially those based on earlier company statements that no longer are accurate.

B. "Safe Harbor" for Forward-Looking Statements

If forward-looking statements are to be made, the company should ensure that they comply with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 (the "Reform Act").[8] In order to encourage companies to provide financial projections and other forward-looking information, the Reform Act provides a statutory safe harbor for forward-looking statements (both written and oral). With some exceptions, the Reform Act generally precludes liability under the federal securities laws for forward-looking statements that were not known to be false when made or that were accompanied by "meaningful" cautionary statements. Meaningful cautionary statements must identify important factors that could cause actual results to differ from the projected results.[9] When the "black day" arrives, the reason or reasons why the forwarding-looking statement did not come to pass will, hopefully, have been clearly articulated among the factors discussed in the cautionary statement.

To ensure timely correction of earlier forward-looking statements, on an ongoing basis, the company should assess the accuracy of its past statements. The scope of that review should not be limited to statements in SEC filings and press releases. Indeed, one federal appellate court recently held that statements made in technical advertisements, which were contained in medical journals, could subject a company to liability under 10b-5.[10] Where significant changes occur, positive or negative, the legal department should be consulted to determine whether any duty exists to correct or update the information previously disclosed.

C. Communications with Analysts

Communications with analysts who follow the company's stock are an important part of every company's investor relations program. Such communications, when done properly, can ensure a proper market valuation of the company's stock, with obvious benefits to the company and its shareholders. However, such communications also can be fraught with danger. Arthur Levitt, Chairman of the SEC, earlier this year gave a speech that addressed this issue.[11] In no uncertain terms, Mr. Levitt stated the SEC's position that a press release should precede any disclosure to analysts.[12] Furthermore, the discussions with analysts after such a press release should not divulge any material information not contained in the press release.[13] He further stated that it is the SEC's position that any trading by analysts or their firms based on information disclosed in an analyst meeting or conference call but not publicly disclosed is illegal insider trading, which can expose both the company, as tipper, and the recipients of the information who trade, as tippees, to liability.[14]

Information disclosed to analysts may also result in a duty to make further corrective disclosures. The distinctions here may be subtle and will require vigilant oversight by the general counsel's office to avoid problems. For example, an analyst may send the company her draft report for comment, or may have a conversation with a company official to "bounce" certain numbers off of her to see if she is in the "ball park." Even a tacit signal that an analyst is on the right track is a statement that may impose a duty to correct on the company and, to the extent that it is not also reflected in a press release, could impose insider trading liability on the company as well.

One way a company can guard against liability arising out of contacts with analysts is to designate a limited number of corporate officers to interface with analysts and to monitor all information (both written and oral) supplied to analysts. The more people who speak to analysts, the greater the chance that the analysts will receive inconsistent information. The "safest course" to avoid liability is for the company to avoid commenting on analysts' estimates or reports.[15] However, if a company does review a report, it is prudent to limit the review to factual matters and to keep a written record of what changes, if any, were requested.[16]

It is critical that companies act prudently in their dealings with analysts. Disclosures to analysts may (1) create subsequent duties to update or correct analysts' false or misleading statements based on an "entanglement" theory[17] and/or (2) result in liability for insider trading based on "selective disclosure" of material, non-public information by the corporate insider to the analysts, who may trade or tip others to trade.[18] Indeed, the Court of Appeals for the Second Circuit has compared the relationship between a corporation and an analyst to "`a fencing match conducted on a tightrope.'"[19]

D. The Corrective Statement

Disclosure to correct an earlier statement should be made as soon as the relevant facts are sufficiently clear to permit an accurate corrective statement to be issued. The disclosure, if it is material, should be through a press release and Form 8K filing with the SEC. The disclosure should be drafted carefully to avoid confusion but communicate frankly the material change in events. Putting a rosy spin on the bad news should be avoided unless absolutely justified. Such "mixed" messages become the cornerstone of strike suits that otherwise would have been precluded effectively by the corrective statement. Corporate counsel familiar with the disclosure requirements of the securities laws should be involved in the drafting process for any such disclosures. If done properly and in a timely fashion, such disclosures can either ward off the filing of a strike suit or set up a solid defense to any that are filed.

E. Insider Trading

A further word about insider trading is warranted in connection with bad news announcements. Among the worst things that can happen in connection with a bad news announcement is for insiders to have sold their stock at a time when the company knew but had not yet announced the bad news. Such activity can provide plaintiffs with scienter on a silver platter. Every company should have and enforce a written securities trading policy and all trades by insiders should be approved by the general counsel's office to minimize the chance that buying or selling occurs at inopportune times.

III. Defending the Strike Suit

Despite all of your best efforts, a strike suit is filed. There are a number of steps that should be taken to dispose of the case quickly or to prepare to try it.

A. Mastering the Facts

It is important at the outset to gain command of all of the facts and, in securities class actions, to ascertain the effect, if any, of the alleged statement or omission on the price of the company's securities. Assembling a detailed chronology with important events plotted on a graph of the company's stock price is an extremely valuable tool in analyzing a securities case. Retention of an econometrician who can analyze what factors move the company's stock price also is of the utmost importance. An econometrician should be engaged early on in the case. Such an expert factors out market-wide and industry-wide effects to isolate firm-specific price movements. This analysis assists in identifying the most important events affecting the company's stock price, and may well provide a solid basis for a method of resolving the case if that is what is determined to be the best course of action.[20]

B. Settlement Considerations

Deciding whether to fight or to settle early on also can have significant benefits. For example, strike suits commonly are filed in connection with announced mergers and acquisitions. Such suits often allege a failure of the board to discharge its fiduciary duties to shareholders by, for example, failing to obtain the highest price for the company's shareholders or by failing to make adequate disclosure to shareholders in proxy or other materials. In the context of a multibillion dollar transaction, such suits clearly are a nuisance. Often management of both the acquirer and the target do not wish the distraction and uncertainty of facing a preliminary injunction proceeding on the eve of the closing of the transaction even if the suit is abjectly meritless.

In such a case, an early decision to attempt to resolve the matter can lead to a more cost effective settlement. The company may, for example, agree to amend the proxy materials after they are filed with the SEC, but before they are finalized and mailed to shareholders, to include those matters that the plaintiff claims should have been disclosed. Such a settlement involves no cash outlay other than for plaintiff's attorneys' fees. Even if the case does not ultimately settle, having flushed out the details of plaintiff's disclosure claim, the company unilaterally can make those changes in its disclosure statements, and thereby lessen the chance of injunctive relief.

In a securities case, the analysis of the econometrician may well provide a basis on which the case can be resolved on a cost efficient basis early on. For example, in *Seagoing Uniform Corp. v. Texaco, Inc.*,[21] a case involving alleged misstatements in Schedule 13Ds, the econometrician's analysis established that the information at issue had, at most, a $.25 per share effect on the stock price over a limited period of time. The case settled at that amount with the defendant's setting aside a fund from which payments could be made to qualifying shareholders but retaining a reversionary interest in unpaid amounts. The ultimate amount paid out was only about one fourth of the theoretical amount once the "ins and outs" (those who both bought and sold during the period affected by the alleged misstatements) and disqualified claimants were removed.

C. Aggressively Attack the Complaint

If the decision is made to fight, there are a wealth of weapons available to the company to dispose of securities class actions and derivative strike suits at the outset. The Reform Act strengthens the requirement for pleading adequately the scienter element of the Rule 10b-5 claim, providing fertile grounds for a motion to dismiss, and it also provides for an automatic stay of all discovery pending resolution of a Rule 12(b)(6) motion to dismiss.[22] As a consequence of these pro-defendant provisions, one effect of the Reform Act has been a perceived "shift" to state court of at least some portion of securities lawsuits in response to the hurdles presented to plaintiffs by the Reform Act.[23] To the extent this shift has occurred, it prevents the realization of some of the intended benefits of the Reform Act, including those expected from the safe harbor provision and the discovery stay.[24] However, at least a few state courts have granted defendants' motions for a stay of discovery under the Reform Act.[25]

Creativity and persistence in finding fatal flaws in a plaintiff's case can pay big dividends by disposing of a case without the cost of discovery and trial. For example, if the statement forming the basis of the plaintiff's complaint "bespoke caution," that can be a basis for dismissal.[26] A plaintiff's inability to plead fraud with specificity and adequately to plead scienter are other strong grounds on which to base a motion to dismiss.[27]

In addition to motions to dismiss, elements of the plaintiff's case may present an opportunity for an early summary judgment motion. For example, most plaintiffs proceed on the so-called "fraud-on-the-market" theory, under which reliance on the misleading statement is presumed by the plaintiff's reliance on the integrity of the market.[28] Without this presumption of reliance, individual issues would predominate over common issues, precluding class certification. However, fundamental to the fraud-on-the-market theory is the efficient market hypothesis, which holds that the market quickly and efficiently absorbs all available public information and reflects the value of that information in the price of a security.[29] This tenet of the efficient market hypothesis often can be fatal to a plaintiff's claim, especially in an omissions case.

Proof that the allegedly withheld information was in fact known to the market precludes a plaintiff from ever proving loss causation, an essential element of a Rule 10b-5 claim. If the information already was in the mix of information in the marketplace, its effect, by definition, already would have been in the price at which the plaintiff either purchased or sold. Therefore, it is impossible for the plaintiff to prove that, had the company made the claimed disclosure, the price the plaintiff paid or received would have been different from that which the efficient market set.[30]

Derivative actions also are vulnerable to substantial attack at the outset. The law of Delaware and most other jurisdictions limits the ability of shareholders to commence derivative suits on behalf of a corporation without first making a demand on the board of directors of the company to file such an action.[31] The failure to satisfy the demand requirement provides a solid basis to head off a derivative suit at the outset. Where a portion of the board may not be disinterested, it may be appropriate to establish a special litigation committee comprised solely of disinterested directors to respond to the demand on behalf of the board.[32] Such a committee should have independent counsel and advice from appropriate financial or other professionals. If conducted properly, this procedure should result in the application of the business judgment rule to the special committee's determination, which means the courts will not second guess the merits of the decision of the board made through the special litigation committee.[33] Care must be taken to ensure that procedural safeguards are followed meticulously since it is that aspect of the special committee's work that will be the subject of the most intense scrutiny by the court.

D. Trying the Case

If the case cannot be disposed of at the outset, it should be defended with the expectation that it will be tried. The best settlements are obtained when the plaintiff truly believes that the defendant is prepared to try the case. Often this results in a game of chicken that proceeds to the proverbial courthouse steps. Although the stakes can be high, in an appropriate case where the company and its counsel believe the case can be defended successfully at trial, the company should try the case. Despite their complexity and the high numbers involved, securities cases can be fairly decided by juries. There are a number of recent examples of companies successfully trying securities cases to juries.[34]

IV. Some Ethical Considerations

One form of strike suit, the derivative action, poses some unique ethical considerations, especially for in-house counsel, that bear some discussion. In a derivative action, although the corporation is a nominal defendant, it is the entity that will benefit if the action is successful. The officers and directors of the corporation, the means by which the corporation acts, often are the true defendants in the action and the ones who will suffer if the action is successful. This tension raises serious ethical issues that must be carefully addressed by counsel.

The Model Rules of Professional Conduct begin, but do not answer, the inquiry. Rule 1.13 (Organization as Client) states that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."[35] The commentary to the Rule specifically addresses the issues potentially raised by the derivative action:

> [A derivative action] may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization. . . . The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. *However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and*

> *the lawyer's relationship with the board.* In those circumstances, Rule 1.7 governs who should represent the directors and the organization.[36]

In *In re Oracle Securities Litigation*,[37] which involved consolidated shareholder class actions and derivative actions arising out of allegations of securities fraud, the district court disapproved a consolidated settlement based on its concerns relating to legal representation in the derivative action. In both the shareholder and the derivative actions, individual officers and directors were named as defendants. The court held that the process by which the disinterested directors approved the derivative settlement failed to satisfy the requirement of good faith and independence under Delaware law.[38]

In *Oracle*, the court described the general counsel's role in the litigation as "distressingly ambiguous."[39] The confusion resulted from inconsistent statements by both Oracle's general counsel and its outside counsel with respect to which clients they represented. At the outset, court filings indicated that Oracle's general counsel represented the insider defendants and its outside counsel represented the corporation in the derivative actions.[40] Subsequently, it appeared that Oracle's general counsel and its outside counsel jointly represented Oracle and the individual defendants.[41] Finally, in response to inquiries by the court, counsel explained that Oracle's outside counsel represented the individual defendants and Oracle's general counsel represented the corporation in connection with the derivative claims.[42]

The court expressed concern about conflicts of interest that arise when the same counsel represents both the corporation and individual defendants in derivative litigation. The court noted that "[d]ual representation is impermissible, particularly at the settlement stage" because, in those circumstances, the corporation's interests are likely to receive "insufficient protection."[43] Indeed, an increased recovery for the corporation is "wholly incompatible with the goal of limiting the [individual] defendants' liability."[44]

The court then concluded that the general counsel faced an impermissible conflict in his representation of the corporation in the derivative suit even absent joint representation because "in-house attorneys are inevitably subservient to the interests of the defendant directors and officers whom they serve."[45] The court also complained that representation of the public corporation by in-house counsel in the derivative suit creates an appearance of impropriety, "particularly where corporate counsel advocates a settlement that is highly favorable to the individual defendants who are his superiors."[46] The court explained the extent of the conflict:

> In the matter before the court, the conflict of interest could not be stronger. The general counsel, of course, is an employee of Oracle. At the same time, the defendants in the derivative action include three of Oracle's senior executive officers . . . and three of Oracle's current directors . . . . It seems indubitable, then, that the general counsel would be reluctant to recommend that the corporation take any position adverse to these men, individual defendants for whom he works on a day-to-day basis and who control his future with the corporation.[47]

Thus, the court found that the reliance by the disinterested directors on the general counsel's advice with respect to the settlement -- which the court found to be "inherently biased" -- made their approval of the settlement "worthless for purposes of analyzing whether the settlement reasonably protects the interests of the corporation and its shareholders." [48]

While the *Oracle* decision has been criticized sharply by corporate counsel,[49] it continues to provide guidance for companies and their counsel in derivative suits. It suggests that, in light of the unique role played by corporate counsel, there are situations that will present at least the appearance of impermissible conflict, weighing in favor of retaining outside counsel. *Oracle* teaches that where the interests of the corporation diverge from the interests of the corporation's constituents, especially those constituents to whom corporate counsel reports, it may not be appropriate for corporate counsel to represent the corporation.[50] Instead, the prudent course may be to retain outside counsel which can in turn: (1) avoid any appearance of impropriety; (2) avoid conflicts between corporate counsel and senior management; and (3) avoid the costs of protracted proceedings like that which took place in *Oracle*.[51]

ENDNOTES

1. Louis M. Thompson, Jr., *Legal Reform Overdue for Securities Litigation System*, Houston Bus. J. (May 26, 1995), *available in* 1995 WL 5873787.

2. *See* Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355, 357 & n.1 (1994).

3. One commentator observed that the following two "ingredients" practically guarantee a strike suit: (1) a "precipitous decline" of the company's stock and (2) positive statements made by management in the months preceding the stock's decline. *See* Gary Rivlin, *How to Bake a Strike Suit*, 8 UPSIDE No. 11, at 58 (Nov. 1996). When company officials have sold large blocks of stock prior to the decline, that fact serves as the "icing on the cake certain to enrich the settlement price." *Id.*

4. *See, e.g.*, *Investors Group Supports Senate Bill Cracking Down on Abusive Securities Lawsuits*, U.S. NEWSWIRE, Oct. 29, 1997, *available in* 1997 WL 13914090; *AHP Officers Accused of Hiding Warnings About Diet Drug Dangers: Oran v. Stafford*, 1997 Andrews Corp. Off. & Directors Liab. Litig. Rep. 21652 (1997), *available in* Westlaw, 1997 ANCODLLR.

5. *See, e.g.*, *Statement on H.R. 1689, The Securities Litigation Uniform Standards Act* (May 19, 1998) (Testimony of Anna G. Eshoo, House Commerce Committee, Subcommittee on Finance and Hazardous Materials). In hearings relating to the passage of the Private Securities Litigation Reform Act, discussed *infra*, discovery costs were described as typically accounting for about 80 percent of a defendant's total litigation costs in a securities fraud case. *See Joint Explanatory Statement of the Committee of Conference*, H.R. Rep. No. 104-369, 31, at 37 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 736. The report also notes that strike suits further threaten companies by requiring key employees to waste

valuable time responding to onerous discovery requests which resemble "fishing expeditions." *Id.*

6. "Silence, absent a duty to disclose is not misleading under Rule 10b-5." *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988); *see also Levine v. NL Indus., Inc.*, 926 F.2d 199, 202 (2d Cir. 1991) (explaining that, for an omission to be actionable under Section 10(b), there must be a duty to disclose the omitted fact and the omitted information must have been material). If a forecast of quarterly results was not made, there may be no duty to disclose poorer than anticipated earnings until the next quarterly report.

7. Other instances in which a duty to disclose material information may arise include when a corporate insider purchases or sells securities in the company and when a statute or regulation requires disclosure. *See* Jonathan N. Eisenberg, *Beyond the Basics: 50 Defense Doctrines That Every Securities Litigator Needs To Know* (1996), *available in* Westlaw, SA90 ALI-ABA 355, at 391; *see also Backman v. Polaroid Corp.*, 910 F.2d 10, 12 (1st Cir. 1990) (stating that information need only be revealed if there is insider trading, if required by statute or regulation or if necessary to prevent a different statement from being materially misleading).

8. 15 U.S.C. § 78u-5; *see also Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995 by the U.S. Securities and Exchange Commission, Office of the General Counsel* (April 1997) (hereinafter "SEC Report"), *available in* Westlaw, 1020 PLI/Corp 61, at 80.

9. SEC Report, *supra* note 8, at 81.

10. *In re Carter-Wallace, Inc. Sec. Litig.*, 150 F.3d 153, 156-57 (2d Cir. 1998).

11. Remarks by Chairman Arthur Levitt, *A Question of Integrity: Promoting Investor Confidence by Fighting Insider Trading* (Feb. 27, 1998).

12. *Id.*

13. *Id.*

14. *Id.*

15. Kevin M. LaCroix, *The Post-Reform Era and Securities Litigation Prevention*, A.B.A. Center for Continuing Legal Education (June 1998), *available in* Westlaw, N98SLIB ABALGLEDI-1. One author recommends the following general guidelines with respect to dealing with analysts: (1) do not tip analysts; (2) when commenting on analysts' earnings estimates, be aware that equivocal statements can create liability; (3) review analysts' reports carefully -- if at all -- and recognize that the proper policies, carefully documented, can prevent liability; (4) think twice before passing out analysts' reports;

and (5) remember that usual disclosure rules apply to communications with analysts. *See* James J. Junewicz, *Handling Wall Street Analysts*, *in* 9 INSIGHTS No. 1, at 13-14 (Jan. 1995).

16. Harvey L. Pitt and Karl A. Groskaufmanis, *For the Issuer, It's Sometimes Tempting to Provide Analysts with Non-public Information. But Selective Disclosure Can Be Perilous*, Nat'l L.J. at B-4 (Apr. 18, 1994).

17. Entanglement cases arise from the company's interaction with analysts during the preparation of reports. In some cases, the company may become responsible for statements contained in an analyst's report based on the company's review and approval (implicit or explicit) of the contents of the report. *See, e.g., Elkind v. Liggett & Meyers, Inc.*, 635 F.2d 156, 163 (2d Cir. 1980) ("[A] company may so involve itself in the preparation of reports and projections by outsiders as to assume a duty to correct material errors in those projections. This may occur when officials of the company have, by their activity, made an implied representation that the information they have reviewed is true or at least in accordance with the company's views."). Alternatively, a company may have a duty to update and correct an analyst's report where the report is attributable to the company. *See In re Cirrus Logic Sec. Litig.*, 946 F. Supp. 1446, 1467 (N.D. Cal. 1996) (explaining that when a company chooses to speak to the market through an analyst, it has a duty to make a full and fair disclosure to ensure that its statements are not materially misleading).

18. *See* John F. Olson, *Dancing on the Tightrope: Dealing with Analysts and the Financial Press; Duties to Update and Duties to Correct* (July 28, 1994), *available in* Westlaw, C951 ALI-ABA 145, at 168; *see also* Junewicz, *supra* note 15, at 9.

19. Olson, *supra* note 18, at 168 (quoting *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8, 9 (2d Cir. 1977)).

20. *See, e.g., Seagoing Uniform Corp. v. Texaco, Inc.*, No. 84 Civ. 1730, 1989 WL 129691, at *6 - *7 (S.D.N.Y. Oct. 24, 1989) (stating in the settlement context that defendant's expert properly analyzed plaintiff's theory of damages by factoring out market-wide and industry-wide influences in order to determine the effect, if any, of firm-specific news announcements on the stock price).

21. No. 84 Civ. 1730, 1989 WL 129691 (S.D.N.Y. Oct. 24, 1989).

22. *See* 15 U.S.C. §§ 78u-4(b)(2) & (b)(3).

23. *See* SEC Report, *supra* note 8, at 139; Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 Stan. L. Rev. 273, 293 (1998) (because the Reform Act "consists predominantly of procedural reforms applicable only in federal

court, it sets the stage for plaintiffs' attorneys to shift some portion of their cases to state court in order to avoid those provisions"). Statistics also indicate that plaintiffs are commencing "parallel proceedings" in both state and federal courts. SEC Report, *supra* note 8, at 75.

24. However, securities fraud plaintiffs may encounter significant hurdles in state court. For example, the "fraud-on-the-market" theory -- a presumption of reliance available in federal securities actions (*see Basic, supra* note 6, at 241-42) — is not recognized in many jurisdictions, requiring a plaintiff to prove actual reliance by each member of the class. *See, e.g.*, Perino, *supra* note 23, at 285 & n.54 (collecting exemplary cases). Additionally, plaintiffs may face jurisdictional limitations under state statutory law, which may require the relevant purchase or sale of securities to have occurred within the state. *See, e.g.*, *id*. at 285-86; Robert W. Brownlie, *Federal Preemption as a Possible Response to a New Challenge: Securities Class Actions in State Court*, 34 Cal. W. L. Rev. 493, 502 (1998). Moreover, plaintiffs may face constitutional difficulties in attempting to certify a nationwide class. *See Phillips Petroleum v. Shutts*, 472 U.S. 797, 821-22 (1985) (application of the law of the forum state to every claim in a nationwide class action suit was arbitrary and unconstitutional). In any event, the problem of a shift to state court may be obviated in the near future. Both the House and the Senate currently are considering versions of the Securities Litigation Uniform Standards Act, which would make federal court the exclusive venue for most securities class action claims. Passage of some version of the Act is expected shortly.

25. *See* SEC Report, *supra* note 8, at 145-46 & n.266 (discussing cases granting and denying stays of discovery in state court).

26. *See, e.g., In re Donald J. Trump Casino Sec. Litig.*, 793 F. Supp. 543, 549 (D.N.J. 1992) ("The essence of the doctrine is that where an offering statement, such as a prospectus, accompanies statements of its future forecasts, projections and expectations with adequate cautionary language, those statements are not actionable as securities fraud."), *aff'd*, 7 F.3d 357 (3d Cir. 1993).

27. *Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1021 (5th Cir. 1996) (affirming dismissal of complaint where plaintiff failed to properly plead scienter); *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1111 (D. Conn. 1991) (dismissing complaint for failure to plead scienter adequately).

28. *See Basic, supra* note 6 at 241-46; *Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975).

29. *Basic, supra* note 6, at 244-45.

30. *See Heliotrope General Inc. v. Ford Motor Co.*, No. 96-0872 (S.D. Cal. Sept. 30, 1997). A motion for summary judgment on loss causation grounds should be distinguished from

the so-called "truth on the market" defense, which is generally raised to defeat the presumption of reliance in order oppose plaintiffs' motion for class certification. *See, e.g., In re SciMed Sec. Litig.*, Civ. No. 3-91-575, 1993 WL 616692 (D. Minn. Sept. 29, 1993). Such attempts often are unsuccessful because of the evidentiary effect of the presumption of reliance in plaintiffs' favor inherent in the fraud-on-the-market theory. Loss causation, on the other hand, is an essential element of a Rule 10b-5 claim for which there is no presumption and on which plaintiff clearly has the burden of proof.

31. *See* ROBERT CHARLES CLARK, CORPORATE LAW § 15.1, at 640-41 (1986).

32. *But see* RALPH C. FERRARA ET AL., SHAREHOLDER DERIVATIVE LITIGATION § 7.05 (1995) (discussing the risk of a finding that making a demand would be "futile" based on the appointment of a special committee). If necessary, a new director who suffers none of the disqualifying characteristics of the current directors can be appointed to the board and serve as a special litigation committee of one.

33. *See, e.g., Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (discussing the business judgment rule).

34. For example, Biogen and American Pacific recently have taken securities fraud cases to trial and emerged victorious. *See Lazar v. Vincent*, No. 94-12177 (D. Mass. May 6, 1998) (Biogen); *De Cumminges v. American Pacific Corp.*, No. 93-590 (D. Nev. Jan. 22, 1995).

35. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (1997).

36. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13, cmts. 10-11 (1997) (emphasis added). Rule 1.7 (Conflict of Interest: General Rule) provides the general rules regarding conflicts of interest, prohibiting, among other things, a lawyer from representing a client if such representation "may be materially limited by the lawyer's responsibility to another client or to a third person, or by the lawyer's own interest." *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7.

37. 829 F. Supp. 1176 (N.D. Cal. 1993).

38. *Id*. at 1177, 1190.

39. *Id*. at 1188.

40. *See id.*

41. *See id.*

42. *See id.*

43. *See id.*

44. *Id.* In addressing the issue of whether outside counsel can represent both the corporation and its directors in a derivative suit, courts have reached different results depending on, among other things, the nature of the allegations against the directors. *See, e.g., Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1316-17 (3d Cir. 1993) (separate counsel not required where the plaintiffs did not allege "serious charges of wrongdoing . . . against the individual defendants," but only "mismanagement, a breach of the fiduciary duty of care"; noting, however, that "except in patently frivolous cases," separate counsel is required where there are allegations of "directors' fraud, intentional misconduct, or self-dealing"); *cf. Musheno v. Gensemer*, 897 F. Supp. 833, 837 (M.D. Pa. 1995) (granting motion to disqualify corporation's counsel under the rationale of *Bell Atlantic*; the individual defendants were alleged to have committed fraud and engaged in willful misconduct); *see also Forrest v. Baeza*, 67 Cal. Rptr.2d 857, 863 (Ct. App. 1997) ("Current caselaw clearly forbids dual representation of a corporation and directors in a shareholder derivative suit, at least where, as here, the directors are alleged to have committed fraud."). In the final analysis, whether joint representation is permissible depends on the facts of each case. *See, e.g., Scott v. New Drug Servs., Inc.*, No. 11336, 1990 WL 135932, at *4 (Del. Ch. Sept. 6, 1990) (noting that "[t]he propriety of joint representation of both the corporation and the director defendants in a derivative action is [a] question on which courts here are divided" and holding that, while separate representation might be "the better practice," it is not required in all situations, including where it is not likely that the corporation will take an "active part" in the litigation).

45. *Oracle*, 829 F. Supp. at 1188.

46. *Id.* at 1189.

47. *Id.*

48. *Id.*

49. *See, e.g.*, Morris W. Hirsch, *The Pendulum Swings Back: General Dynamics and Other Signs of Changing Fortunes of In-House Counsel*, Nev. Law. (March 1995), *available in* Westlaw, 3-MAR NVLAW 13.

50. *See* Sally R. Weaver, *Ethical Dilemmas of Corporate Counsel: A Structural and Contextual Analysis*, 46 Emory L. J. 1023, 1045-46 (Summer 1997).

51. *See id.* Professor Weaver suggests various ways that, in general, corporate counsel can clarify their role and thus avoid confusion about the identity of "the client," minimize conflicts and otherwise serve their clients most effectively. *See id.* at 1032-51; *see also*

Geoffrey C. Hazard, Jr., *Ethical Dilemmas of Corporate Counsel*, 46 Emory L.J. 1011 (Summer 1997).