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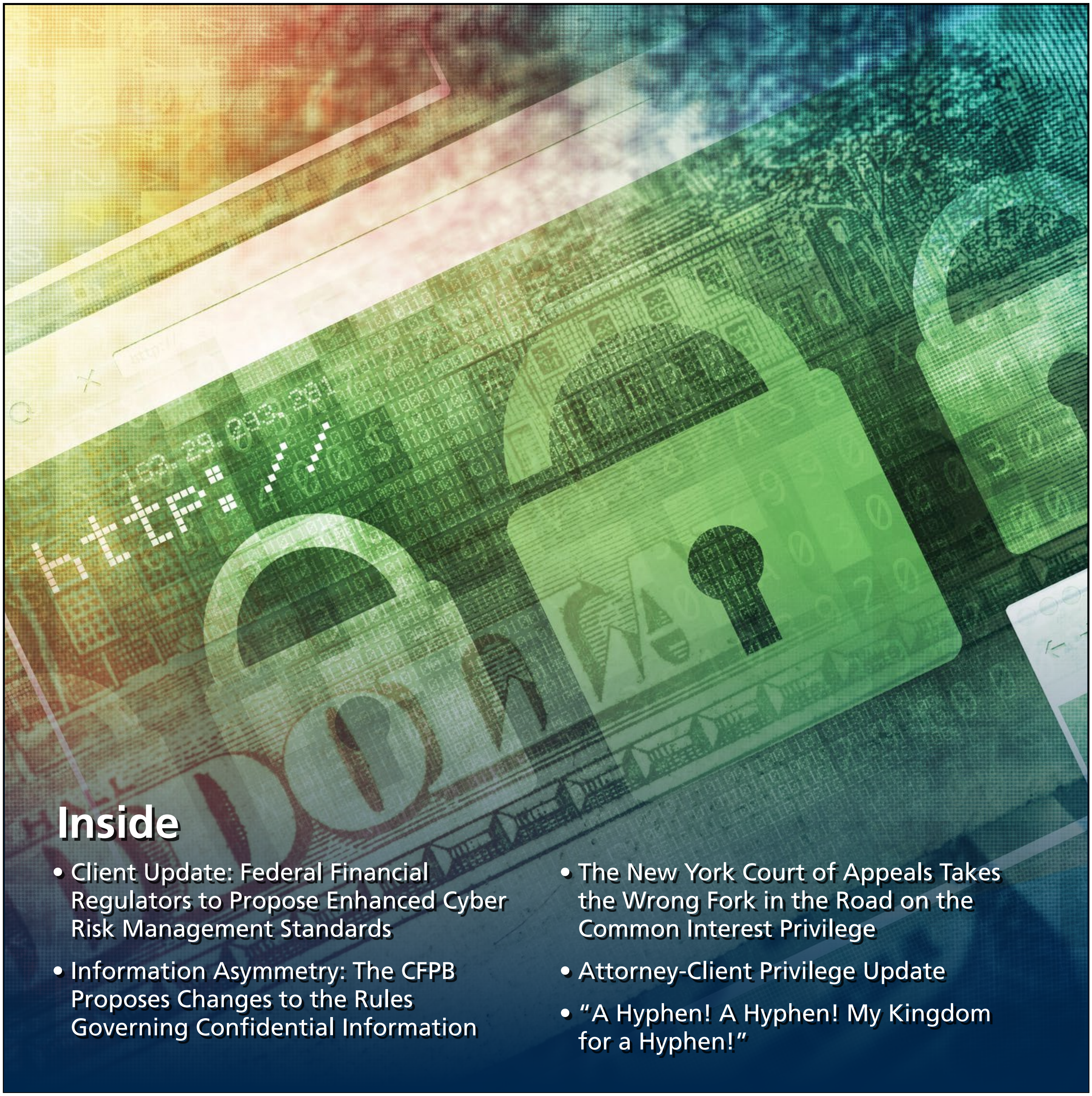

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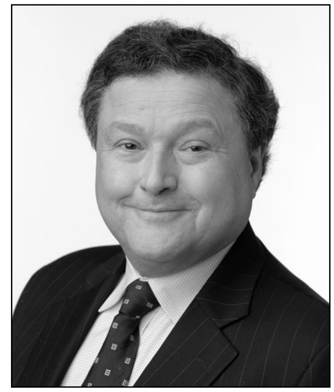
HeadNotes

The 2016 elections may presage a seismic shift for the regulatory environment affecting businesses and the attorneys who advise them. The election of Donald Trump as president, along with Republican majorities in the House and Senate, not to mention record Republican dominance of state legislatures and governorships, is widely anticipated to herald at least a slowdown, if not a rollback, in the regulatory burden on most businesses. At the same time, however, the waning days of the Obama Administration have seen a full-court press by the federal agencies to complete and implement rulemakings in a number of critical areas. While it is of course too early to assess the full impact of these developments, our contributors to this issue highlight some potentially key changes affecting employers, consumers, and financial institutions.

Meanwhile, New York remains firmly in the "blue state" column, and developments in State law and regulation continue to pose new challenges for the State's businesses and their attorneys. If anything, State initiatives in areas such as consumer protection are likely to be even more aggressive, to compensate for a perceived rollback of these protections at the federal level. In particular, the State's Department of Financial Services ("DFS"), which has jurisdiction over insurance and banking and other financial service entities chartered, licensed or supervised by the State, has shown little hesitation in recent years toward being out front, even in areas where federal authorities have traditionally taken the lead. Aside from aggressive enforcement actions for violations of law, the DFS has taken a prominent role over the past year in three areas:

- *Anti-Money Laundering*: early in the year the DFS promulgated a new Part 504 of the Superintendent's Regulations, which imposed substantially heightened standards on State-chartered or licensed banking entities, and non-banking entities such as check cashers and money transmitters, with respect to anti-money laundering (AML)—notwithstanding that the principal AML laws are federal and are enforced by the federal regulatory agencies. The new Part 504 imposes enhanced procedures for transaction monitoring and "filtering" and requires that each institution file a Board Resolution or a Certification prepared by a senior officer confirming compliance with the new requirements. As originally proposed Part 504 threatened criminal liability for the institution's chief compliance officer if it failed to comply; in response to comments filed by NYSBA's Banking Law Committee and others this was softened to the annual compliance certification requirement. Still, one effect may well be to make it more difficult for state-chartered institutions to hire or retain competent compliance officers. And since Part 504 does not apply to federally chartered banking institutions as a matter of basic federal preemption, it provides yet another disincentive for banks and other financial service companies to organize under New York State law.



- *Abandoned Property*: In June the State Legislature amended Sections 1301 and 1308 of the Real Property Actions and Proceedings Law, to impose on certain banks and other holders of first mortgage liens the responsibility to maintain vacant or abandoned one-to-four family properties. The purpose of the law is to expedite the rehabilitation and repair of "zombie" properties, to establish a registry of such properties, and to assist homeowners facing foreclosure. But in the view of the New York Bankers Association (NYBA) and others, the implementing regulations adopted by the DFS (Part 422 of the Superintendent's Regulations), which took effect December 20, 2016, go well beyond the requirements of the law itself. One effect, albeit unintended, may be to make residential mortgage credit less available, or more expensive, in the State. As noted by the NYBA in its comment letter, the problem of abandoned properties is exacerbated by New York's prohibitively difficult foreclosure procedures; on average, it takes more than three years for the process to be completed, as—unlike in most other states, but protected in New York by the trial lawyers—all foreclosures must go through the judicial system. NYBA notes further that New York had one of the lowest foreclosure rates in the country before the financial crisis; now, in part due to the length of the foreclosure process, it has one of the highest.

- *Cybersecurity*: In recognition of the increasing threat posed to New Yorkers by potential attacks on computer systems which hold their private information, in August the DFS proposed major new regulations imposing heightened cybersecurity requirements on essentially all entities within its extended reach. Numerous industry groups, including the Securities Industry and Financial Markets Association (SIFMA), the New York Bankers Association, and the Institute of International Bankers, have filed comment letters. Among other things, the commenters have indicated that some of the requirements are simply unworkable, are inconsistent with other laws and regulatory requirements, are out of step with developing industry standards, and cannot in any event be implemented on the tight time frame the DFS has indicated—the regulation was to become effective January 1, 2017, albeit with a phase-in for its key provisions. But perhaps most tellingly, the DFS has defined the scope of the regulation's reach so broadly—essentially, it would apply to any entity that is in any way licensed or supervised by the DFS—that it would appear to have extraterritorial application to entities based in other states, or even other countries, that have operations in New York. As a practical matter, most companies' systems are integrated to an extent that it is not possible to isolate the New York operation from other jurisdictions, and an enterprise-wide approach clearly makes the most sense in any event. As this issue went to press, the DFS was still considering the comments it had received. In future issues we will continue to follow this critical issue closely.

"Apropos: probably the hottest single topic currently for businesses and their lawyers is the increasing prevalence of cybersecurity breaches and related crimes, including identity theft."

Apropos: probably the hottest single topic currently for businesses and their lawyers is the increasing prevalence of cybersecurity breaches and related crimes, including identity theft. Even as the New York DFS pursues its initiative, the federal banking regulators have also issued an Advance Notice of Proposed Rulemaking (ANPR) proposing enhanced standards for cyber risk management for large institutions—generally, those with $50 billion or more in assets—under their supervision. But attorneys for other businesses need to be alert to this as well; among other things, the ANPR seeks comments on whether these standards should be applied to third-party providers of services to these institutions, and indicates that the standards would be applicable to their subsidiaries (the comment period was scheduled to end on January 17, 2017). Our lead article in this issue, prepared by the attorneys of Debevoise & Plimpton, discusses the ANPR and its ramifications, and explains the five areas covered by the enhanced standards: cyber risk governance; cyber risk management; internal dependency management; external dependency management; and incident response, cyber resilience, and situational awareness. In addition, even higher standards would be imposed on those systems identified as "critical to the functioning of the financial sector."

The protection of confidential information is on the regulatory agenda of the federal Consumer Financial Protection Bureau (CFPB) as well. But in its usual high-handed way, the CFPB is now proposing changes to its rules that parties ranging from the American Civil Liberties Union to the U.S. Chamber of Commerce have decried as violating First Amendment protections on free speech. In "Information Asymmetry: The CFPB Proposes Changes to the Rules Governing Confidential Information," attorney Ori Lev discusses the proposed changes. The Bureau's current rules, modeled on those of the Federal Trade Commission (FTC), generally prohibit the CFPB itself from disclosing the existence of a Civil Investigative Demand (CID), in order to protect the target of a CID—which is not itself the finding of any wrongdoing—from potential adverse publicity. But now the Bureau proposes to change the rule—on the one hand, to give itself more leeway to disclose CIDs to other agencies, and on the other, to prohibit the recipient of the CID from voluntarily disclosing its existence to third parties. Mr. Lev, a partner in Mayer Brown's Financial Services Regulatory & Enforcement Group, notes that, apart from its apparent violation of the right of free speech under the Constitution, this change—for which the CFPB provides no explanation or justification—could preclude companies from disclosing the existence of a CID as a material event in filings with the Securities & Exchange Commission, or to a counterparty to a contract that may require such disclosure.

The Editor would note that the CFPB's high-handed approach does not come as a surprise to attorneys who have followed its activities to date. In a recent case, *PHH Corp. v. CFPB*, the D.C. Circuit invalidated its imposition of a penalty of $109 million on a captive mortgage re-insurer, for what amounted to a retroactive violation of the CFPB's interpretation of law based on activities that were permissible at the time under an earlier interpretation by the U.S. Department of Housing and Urban Development (HUD). Among other things, the court held that the CFPB's assertion that the law's statute of limitations did not apply to its administrative enforcement actions had no basis in law, and that its action violated fundamental principles of due process. But the court also pointed to the more basic underlying problem: the way the CFPB is structured under the Dodd-Frank Act, which created it, vests all its power in a single Director who is appointed by the president but—unlike Cabinet officers and other presidential appointments—cannot be removed at will. This has the effect of giving the CFPB Director free rein to do as he pleases with no checks and balances, making him the most powerful figure in the government other than the president. This, said the court, is unconstitutional. With the court having invalidated this part of the law, one may anticipate that the current Director, Richard Cordray, will be removed by the new president prior to the scheduled end of his five-year term in 2018. While the CFPB is unlikely to be abolished outright, proposed legislation in the Congress to amend the Dodd-Frank Act would restructure the agency by creating a five-person board, similar to the SEC, the Commodity Futures Trading Commission (CFTC), and other agencies. We will report on these developments in future issues.

Another area of law likely to undergo significant changes under the new Administration is employment law, particularly in regard to health care and retirement benefits. While it is obviously too early to have any certainty, pronouncements to date by Mr. Trump and his transition team are indicative of the likely direction the new Administration will take. In "Employee Benefits in the Trump Administration: What Can Employers Expect?" Professor David Pratt of Albany Law School provides a comprehensive overview of both state and likely federal changes in areas such as employer health plans, prescription drug costs, retirement benefits, paid sick leave programs, and other areas of vital concern. Noting that employers must plan despite the uncertainty surrounding the future of the Affordable Care Act (also known as "Obamacare"), Professor Pratt brings his considerable insights to bear on the likely direction and magnitude of the forthcoming changes. It is must reading for attorneys who are seeking to guide their business clients in what looks to be a turbulent period of change.

As always, employment law remains a principal area of concern for New York businesses and their attorneys. A regular feature of the *Journal*, highly valued by our readers, is "Recent Employment Laws Impacting Private Employers in New York," prepared by attorney Sharon Parella. In this issue Ms. Parella, a recognized expert on employment law and a member of the *Journal*'s Advisory Board, reports on the federal Defend Trade Secrets Act of 2016, pursuant to which employers may now pursue claims for misappropriation of trade secrets in federal district courts. This new law, however, contains various immunity provisions that generally protect employees who disclose trade secrets in connection with reporting suspected violations of law to government officials or commencing workplace retaliation lawsuits based on their having made such reports. It also limits the scope of damages available to employers who fail to notify their employees about the immunity provisions. It is evident that companies for which trade secret protection is important will be seeking advice on how to best respond to the new law. On the local front, the New York City Council has introduced a proposed bill to promote flexible working arrangements that would, among other things, require employers to make temporary schedule changes for employees in certain emergency situations and prohibit retaliation against employees who seek flexible working arrangements. In another development, the New York City Commission on Human Rights has released new Legal Enforcement Guidance concerning discrimination on the basis of pregnancy. And in cooperation with the State, the Commission also has announced comprehensive campaigns intended to eradicate discrimination and bias more generally. Ms. Parella is the founder of the Parella Firm P.C. and Workplace Bullying Resources, Inc., which provides training and counseling services aimed at preventing bullying behavior in the workplace.

Business lawyers in New York often include, in commercial agreements of many types, a standard "choice of law" provision calling for any disputes to be decided in accordance with the laws of New York. But as ever, the Law of Unanticipated Consequences is lurking in the shadow, ready to lay traps for the unwary. In "Standard New York Choice of Law Provisions May Apply Foreign Laws to Bar Claims," attorneys William J. Hine and Sevan Ogulluk illustrate how a plethora of confusing jurisprudence, applying New York's "borrowing statute," has resulted in, for example, the application of multiple statutes of limitation to the same claim depending upon the home jurisdiction of each party, even where it was clearly intended that the New York statute should apply. Furthermore, as the authors illustrate, it is not always easy, or even possible, to draft around this problem. Mr. Ogulluk is a partner and Mr. Hine is of counsel with Jones Day in New York City. Their article is timely and essential reading for all New York business lawyers.

Another feature of the *Journal* that is highly prized by our readers is the ongoing series on legal ethics topics by C. Evan Stewart, a partner in Cohen & Gresser. Never one to mince words, in his latest entry Mr. Stewart tells us that "The New York Court of Appeals Takes the Wrong Fork in the Road on the Common Interest Privilege." With his usual witty analogy to pop music of the baby boomer era—in this case, Lesley Gore's "It's My Party and I'll Cry if I Want To!" —Mr. Stewart sheds tears over the Court's failure to confirm his prediction that the Court would "get it right" on this important issue. Specifically, he focuses on the Court's decision in *Ambac Assurance Corp. v. Countrywide Home Loans*, a case resulting from the 2008-9 financial crisis, during which Countrywide failed and was acquired by Bank of America. Before they merged, the Bank and Countrywide entities entered into a "common interest agreement," enabling them to share legal advice to facilitate compliance with the many complex legal and regulatory issues involved. The courts have recognized the "common interest privilege" as an exception to the basic rule that the attorney-client privilege is waived when the attorney's advice is shared with a third party. Reversing the lower court, the Appellate Division, First Department held that the common interest privilege applied to documents produced by the Bank. But in June 2016, the Court of Appeals reversed, holding that the privilege did not apply. In his usual clear and cogent fashion, Mr. Stewart explains the significance of the Court's ruling. As reported in our previous issue, Mr. Stewart, a member of the *Journal*'s Editorial Board, is the recipient of the NYSBA's prestigious Sanford D. Levy Award, given annually by the NYSBA's Committee on Legal Ethics to an individual or institution that contributes significantly to the advancement of legal ethics. The editors are especially proud that the Committee cited Mr. Stewart's contributions to the *Journal* as a prime factor in his selection.

The common interest privilege is not the only aspect of the attorney-client privilege that has been before the New York courts in 2016. In "Attorney-Client Privilege Update," Professor Michael J. Hutter of Albany Law School reviews three significant decisions in this area. First, he offers his take on the *Ambac* decision of the Court of Appeals, discussed in depth in Mr. Stewart's article. Second, he discusses the First Department decision in *NAMA Holdings, LLC v. Greenberg Traurig, LLP*, which concerned the "fiduciary" exception to the privilege. Under the fiduciary exception, communications between a trust's trustee and his attorney cannot be withheld from the trust's beneficiaries in a case involving breach of fiduciary duty, since they are the real party in interest. The question in the case was whether this exception applies in the context of shareholder litigation. And third, he discusses another First Department case, *Stock v. Schnader Harrison Segal & Lewis*, which dealt with the applicability of the privilege to intra-firm communications. Professor Hutter writes a regular column on matters of legal ethics for the *New York Law Journal*.

Another invaluable ongoing feature of the *Journal* is "Inside the Courts." Prepared by the attorneys of Skadden Arps, "Inside the Courts" is a comprehensive review of all significant securities-related litigation pending before the federal courts. The latest installment deals with matters ranging from class actions through statute of limitations and tolling issues, and includes a thoughtful analysis of *PHH Corp. v. CFPB*, which we discussed above. The editors remain grateful to Skadden and its attorneys for their great generosity in sharing their knowledge and expertise with our readers.

Providing a fitting capstone to this issue—and completing a triptych of excellent contributions from the faculty of Albany Law School, which sponsors and supports our *Journal*—is the *Journal*'s Managing Editor, Albany Law Professor James Redwood. In "A Hyphen! A Hyphen! My Kingdom for a Hyphen!" Professor Redwood illustrates how, in a case involving judicial dissolution of a closely held New York corporation, the omission of a hyphen in the plaintiff's complaint apparently led the Court to a remedy that was not in the contemplation of the plaintiff. Paraphrasing the famous line from Shakespeare, "A horse! A horse! My kingdom for a horse!" (Richard III), Professor Redwood makes the larger point: in the increasing complexity of modern legal practice, even minor carelessness in drafting can have major consequences. Or to expand the metaphor with the old proverb: "For want of a nail, the shoe was lost . . ."

David L. Glass

Client Update: Federal Financial Regulators to Propose Enhanced Cyber Risk Management Standards

By the Attorneys of Debevoise & Plimpton

On October 19, 2016, the Board of Governors of the Federal Reserve Systems, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the "Agencies") issued an Advance Notice of Proposed Rulemaking ("ANPR") regarding enhanced cyber risk management standards for certain entities under their supervision (the "Enhanced Standards").[1] The ANPR contemplates that the Enhanced Standards would cover five topic areas—cyber risk governance; cyber risk management; internal dependency management; external dependency management; and incident response, cyber resilience, and situational awareness. The ANPR also contemplates that even higher standards would apply to those systems identified as "critical to the functioning of the financial sector."

In addition to this two-tiered approach to standards, the ANPR seeks input on the development of a repeatable and consistent scoring system to quantify cyber risk across a range of entities. And, while recognizing that the FFIEC Cybersecurity Assessment Tool and NIST Cybersecurity Framework already provide cybersecurity guidance to financial institutions, the ANPR suggests that its enhanced standards could go beyond this guidance by providing binding requirements for covered entities to meet. The ANPR leaves open the precise form of the Enhanced Standards, instead laying out three possibilities ranging from policy guidance (like the approach taken in other areas), to more specific standards, to granular regulations with which entities would need to comply.

Who Would Be Covered?

The ANPR contemplates the application of the Enhanced Standards to regulated entities with consolidated assets of $50 billion or more, including subsidiaries of those entities and foreign banks with U.S. operations.[2] The ANPR specifically notes that subsidiaries of covered entities would be subject to the Enhanced Standards "in view of the subsidiaries' potential to act as points of cyber vulnerability to the covered entities." In addition, the Enhanced Standards may be extended to nonbank financial entities under the supervision of the Federal Reserve pursuant to the Dodd-Frank Act.

Perhaps most notably, the ANPR seeks comment on whether the Enhanced Standards ought to apply to "third-party service providers" of covered entities. This proposal—which is a natural outgrowth of regulators' increasing focus on third-party risk—likely, will generate substantial discussion during the comments period.

The Five Categories

Although still at the ANPR stage, the Enhanced Standards' categories are worth further examination, particularly because some of them contain granular suggestions for comment. We identify a few particularly noteworthy aspects below.

Governance

Sounding a common theme with earlier guidance, the ANPR suggests cybersecurity must be an exercise in enterprise-wide risk management involving the very highest levels of the organization. (This theme will be familiar from, among other guidance, the Interagency Guidelines Establishing Information Security Standards.) The ANPR proposes significantly more granular steps, however, including:

- That a board-reviewed and approved plan be established that not only speaks to inherent cybersecurity risks (that is, cyber risk before mitigating controls or other factors are considered) but also residual cyber risk.
- The establishment of a formal risk tolerance with respect to cyber, with a requirement that the board review and approve the proposed risk appetite.
- A requirement that the board of directors have adequate expertise in cybersecurity or maintain access to appropriate resources to discharge their duties in this regard.
- Demanding that those responsible for cyber risk be independent of business units, and have independent access to the board of directors.

The level of board involvement contemplated, and the requirement regarding board expertise, merit consideration, as they suggest the Agencies may examine board composition to ensure adequate experts exist within the board or, barring that, suggest that boards will need to retain their own cyber experts to manage cyber risks.

Cyber Risk Management

The ANPR conceives cyber risk management cutting across three independent functions:

- Business units, which would be required to assess cyber risks and adhere to policies and procedures designed to manage those risks;
- Independent risk management, which would assess cyber risks across the enterprise and have its own

line of reporting to an appropriate officer and/or the board of directors; and

- Audit, which would be required to develop a full audit plan to measure the effectiveness of the cyber risk controls, including through penetration testing and other vulnerability assessments consistent with an entity's size, complexity, scope of operations, and interconnectedness.

Particularly noteworthy is the ANPR's suggestion that the independent risk management function may be tasked with measuring cyber risks quantitatively. As noted above, the ANPR seeks comments regarding methods for creating such a quantitative measure that could be consistent and repeatable across entities.

Internal Dependency Management

Under this heading, the ANPR proposes a series of steps to manage cyber risks arising out of not only technology, but also workforce and facilities issues. The proposal places emphasis on maintaining an updated inventory of "all internal assets and business functions" supporting a firm's cyber risk management strategy. If such a principle ultimately is adopted, it would transform the current best practice of knowing your assets and architecture into a legal requirement.

External Dependency Management

Not surprisingly, the ANPR devotes substantial time to third-party vendor management, focusing on procedures used through the vendor lifecycle including due diligence, contracting and sub-contracting, onboarding, monitoring, change management, and offboarding. The ANPR, however, goes deeper and suggests that covered entities would need to "monitor in real time" all external dependencies and trusted connections supporting cyber risk management. Given the time and expense associated with such real-time monitoring, this portion of the proposal may generate substantial discussion.

Incident Response, Cyber Resilience, and Situational Awareness

This fifth and last category reflects the reality that even if entities enhance their cybersecurity, breaches and attacks will happen nonetheless. The ANPR contemplates requiring covered entities to develop plans to mitigate and contain damage, giving emphasis to the storage and maintenance of back-ups of critical files. The more granular aspects of the proposal include:

- Requirements that covered entities consider "secure, immutable, off-line storage of critical records";
- Identification and designation of alternative service providers for critical functions;
- Consideration of a multi-sector cyberattack across industries, "such as energy and telecommunications"; and
- The creation and maintenance of threat profiles and threat modeling consistent with identified risks.

Key Observations

Although still at the ANPR stage, a few themes clearly emerge:

- Cyber risk is enterprise risk. The word "enterprise" litters the ANPR, and many of the proposals clearly set forth a view that cyber risk must begin at the top and pervade the business. The message is plainly that businesses no longer can treat cybersecurity as simply an IT problem, and that even the board will be expected to have sufficient resources internally (or, if lacking, externally) to understand and manage it. Notably, this paradigm informs the ANPR's effort to develop—and to seek comments on—a quantitative measure of cyber risk that can be applied across industries.

- Third-party risk must be managed. The ANPR both suggests that the rules might be applied directly to third-party providers, and sets forth a series of considerations for how covered entities must approach their third-party vendors. There is a particular awareness of the interconnectedness of the banking sector and, as a result, covered entities would be expected to maintain–in real time–an understanding of both internal and external dependencies, as well as a complete inventory of their information and technology assets, whether held internally or managed through a third party.

- Breaches will happen, so resilience is key. The ANPR spends considerable time focusing on the steps that covered entities would need to take to plan for, and respond to, cyber attacks. Indeed, the ANPR proposes a two-hour recovery time objective for the so-called "sector critical systems" of covered entities, which could be challenging in practice.

Technological best practices continue to harden into regulatory requirements.

Finally, the ANPR is yet another example of technological best practices hardening into regulatory requirements. Much remains, of course, to be worked out. There is, however, little doubt that some measures previously considered "best practices" will now become legally enforceable obligations on covered entities.

What's Next?

The Agencies are seeking comment from stakeholders on the ANPR, and plan to use the information gathered to develop a more detailed proposal, which will also be open to public comment. The deadline for submitting comments on the ANPR is January 17, 2017.

Endnotes

1. The ANPR comment period concludes on January 17, 2017, after which the Agencies will promulgate a more detailed proposal followed by an additional comment period.
2. Specifically, the proposed covered entities include the following institutions:

   • Those regulated by the FRB: U.S. bank holding companies with total consolidated assets of $50 billion or more; the U.S. operations of foreign banking organizations with total U.S. assets of $50 billion or more; U.S. savings and loan holding companies with total consolidated assets of $50 billion or more; nonbank financial companies designated for FRB supervision by the Financial Stability Oversight Council ("FSOC"); financial market utilities designated by the FSOC for which the FRB is the supervisory agency per the Dodd-Frank Act; other financial market infrastructures for which the FRB is the primary supervisory agency or are operated by Federal Reserve Banks; any state member bank (and any subsidiaries thereof) that is a subsidiary of a bank holding company with total consolidated assets of $50 billion or more; and, any state member bank that has total consolidated assets of $50 billion or more that is not a subsidiary of a bank holding company. The FRB's standards would apply to subsidiaries of depository institution holding companies (other than depository institutions supervised by the OCC or FDIC, which are covered separately).

   • Those regulated by the OCC: Any national bank, federal savings association (and any subsidiaries thereof) or federal branch of a foreign bank that is a subsidiary of a bank holding company or savings and loan holding company with total assets of $50 billion or more; and, any national bank, federal savings association, or federal branch of a foreign bank that has total consolidated assets of $50 billion or more that does not have a parent holding company.

   • Those regulated by the FDIC: any state nonmember bank or state savings association (and any subsidiaries thereof) that is a subsidiary of a bank holding company or savings and loan holding company with total consolidated assets of $50 billion or more; and, any state nonmember bank or state savings association that has total consolidated assets of $50 billion or more that does not have a parent holding company.

Information Asymmetry: The CFPB Proposes Changes to the Rules Governing Confidential Information

By Ori Lev

The Consumer Financial Protection Bureau (CFPB) recently proposed changes to its rules governing confidential information. The proposed rules would restrict recipients of civil investigative demands (CIDs) from voluntarily disclosing the receipt of a CID, while at the same time giving the CFPB more leeway to disclose confidential supervisory information to other government agencies. The proposed simultaneous tightening and loosening of restrictions on the disclosure of confidential information can have important implications for parties subject to CFPB enforcement and supervisory jurisdiction.

Confidential Investigative Information—Limitations on Recipients of CIDs

From their inception, the CFPB confidentiality rules governing the treatment of CIDs and CID-related information have been fraught with ambiguity with regard to what limitations, if any, they impose on CID recipients. The rules as originally promulgated and currently in effect generally prohibit the CFPB from disclosing any confidential investigatory information—defined to include any information provided to the CFPB in response to a CID, as well as any other information prepared or received by the CFPB in the conduct of enforcement activity.[1] The rules appear intended to protect investigation targets from being tarred by the mere existence of an investigation, which does not equal a finding of wrongdoing. In this respect, the CFPB's practice is modeled on that of the Federal Trade Commission (FTC), which similarly does not disclose pending investigations.

The application of the current confidentiality rules to CID recipients—and specifically whether they purport to prohibit a recipient of a CID from voluntarily disclosing the existence of the CID or other CID-related information—is less clear. On the one hand, the rules define confidential investigative information as including information "prepared by. . .the CFPB. . .in the conduct of an [enforcement] investigation," suggesting that the definition includes the CID itself and not merely information provided by a CID recipient to the CFPB.[2] The rules also provide that "except as required by law," no "person in possession of confidential information" may disclose it.[3] Together, these provisions suggest that a recipient of a CID is prohibited from disclosing the existence of a CID absent a legal obligation to do so.

On the other hand, the current rules appear to be intended to protect subjects of investigations by preventing the CFPB from disclosing the existence of an investigation or materials provided to it in response to a CID absent an applicable exception. For example, the preamble to the rules discusses the sensitive nature of information the CFPB obtains and states that the rules "generally prohibit[] *the Bureau and its employees* from disclosing confidential information."[4] And the rules themselves state that "no current or former employee or contractor or consultant of the CFPB" may disclose "confidential information" except as required by law or authorized by the rules.[5]

Other textual clues, and the CFPB's practice over the past five years, support the conclusion that the current rules authorize voluntary disclosure of the existence of a CID by its recipient. Most importantly, the current rules differentiate between how entities subject to CFPB examination or investigation can handle confidential supervisory information and confidential investigative information, respectively. As the preamble to the current rules explains, they expressly "prohibit[] institutions from further disseminating confidential *supervisory information* they receive [from the CFPB] except in limited circumstances."[6] This approach to handling confidential supervisory information is consistent with that of the prudential regulators. In light of this broad prohibition, and recognizing supervised entities' need to disclose such information in certain circumstances, the rules expressly authorize certain disclosures of confidential supervisory information. Thus, section 1070.42 of the current rules expressly allows a supervised financial institution to disclose confidential supervisory information to its attorneys.[7] The current rules also provide a mechanism by which a supervised financial institution may seek authorization from the CFPB to make additional disclosures of confidential supervisory information.[8] Indeed, the CFPB went so far as to issue a Compliance Bulletin emphasizing that those in possession of confidential supervisory information may not disclose it without such authorization.[9]

There are no parallel disclosure provisions governing confidential investigative information. That is, the current rules do not expressly authorize sharing confidential investigative information with counsel and provide no mechanism by which to seek CFPB permission to otherwise disclose such information. (Nor did the CFPB Bulletin discuss the disclosure of confidential investigative information.) In light of the fact that confidential investigative information is subject to the same general prohibitions on disclosure as confidential supervisory information, this absence can mean one of two things: either CID recipients are absolutely prohibited from disclosing the existence of a CID and other CID-related materials, even to counsel, or the non-disclosure provisions are not intended to apply to recipients of CIDs. Clearly, the first option is untenable. CID recipients regularly disclose CIDs to their counsel and also disclose the existence of CIDs to various business counterparties in a variety of circumstances with the CFPB's knowledge (and even express agreement). This practice strongly suggests that the current rules do not, in fact, prohibit CID recipients from disclosing confidential investigative information but are instead focused on the CFPB's non-disclosure of such information.

Moreover, the CFPB's template CID form itself does not state that disclosure of its existence would violate the CFPB's rules. To the contrary, when the CFPB issues CIDs to third parties who are not the subject of the investigation, the CID's instructions *request*, but do not direct, the recipient to keep the existence of the CID confidential.[10] This provides further support to the conclusion that the rules as currently written are not intended to preclude voluntary disclosure of a CID by its recipient.

The CFPB provides no explanation or justification for adopting this approach other than to note that it would impose the same information-sharing regime on confidential investigative information as currently exists for confidential supervisory information.[13] Nor does the CFPB discuss the relative merits of imposing such a non-disclosure regime versus allowing recipients of CIDs to voluntarily disclose them if they wish, or identify any harms that would result from a permissive disclosure regime.

These are all serious issues that warrant careful consideration by the agency rather than the cursory treatment provided in the proposed rules. While the proposed rules would treat confidential investigative information consistently with the agency's treatment of confidential supervisory information—and consistently with the manner in which prudential regulators treat confidential supervisory information—they would be a stark departure from the practice of other law enforcement agencies such as the FTC or the Securities and Exchange Commission (SEC). Neither of those agencies prohibits disclosure of CIDs or subpoenas by recipients. The CFPB's statutory authority to issue CIDs is modeled after that provided to the FTC, and the CFPB's investigation rules are modeled on the rules of both agencies. The decision to align the rules governing confidential investigative information with the practices of the prudential regulators, as opposed to the law enforcement agencies upon whose legal authorities the CFPB's enforcement powers were modeled, represents a sharp departure from past CFPB practice. Particularly in light of the fact that in their long experience the FTC and SEC have not identified a need to prohibit CID or subpoena recipients from disclosing the existence of an investigation, the CFPB's proposal warrants careful scrutiny.

"By prohibiting the disclosure of information absent advance permission from the CFPB, the proposed rules appear to impose a prior restraint and a content-based restriction on speech."

Why does this matter? While CID recipients often wish to keep the existence of an investigation confidential, there are circumstances in which a company may wish to voluntarily disclose an investigation's existence. Certainly, a company will want to disclose the CID to its outside counsel to obtain legal advice. A company may wish to disclose a CID to its insurance carrier in order to obtain coverage for defense costs. Additionally, a company may be contractually obligated or otherwise wish to disclose a CID to counterparties, as the result of a contractual commitment, pending transaction or for another reason. Or a company may wish to disclose receipt of a CID in an effort to criticize the CFPB for overreaching or otherwise to shed light on the agency's operations.

The CFPB now proposes to clarify the ambiguity in its current rules by expressly prohibiting the disclosure of a CID, or other materials an investigation target prepares in response to an investigation, except in limited circumstances. Specifically, the CFPB proposes to "expand[] the scope of § 1070.42 [the provision authorizing the disclosure of confidential supervisory information in narrow circumstances or with the CFPB's approval] to address its enforcement activities in addition to its supervisory activities."[11] The CFPB makes clear that this proposed change would cover—and generally prevent—the disclosure of "civil investigative demands ('CIDs') [and] notice and opportunity to respond and advise ('NORA') letters."[12]

Existing practice also suggests that the CFPB's proposed rules may be unwarranted. The CFPB's current rules provide for the disclosure of CIDs under several circumstances. Because the rules as currently written (and as proposed) authorize disclosure when "required by law,"[14] publicly traded companies that believe that receipt of a CID or NORA letter constitutes a material event regularly disclose such events in their securities filings. Similarly, the CFPB will publicly disclose CIDs when recipients avail themselves of the right to petition to modify or quash a CID.[15] The CFPB's proposal does not identify any harm to its enforcement program that has come from such disclosures. As discussed below, one could envision harm to an agency's enforcement objectives when an investigation's target that is unaware of the investigation becomes informed about it. But even in cases where the CFPB sends CIDs to third parties, it has only requested, and not required, that those parties keep the existence of the investigation confidential. Given the history of the disclosure of CIDs and the absence of any identified harm to the CFPB from such disclosures, it is not clear why the CFPB is proposing to limit such disclosures in the future.

Finally, and perhaps most importantly, the proposed rules raise Constitutional concerns under the First Amendment. By prohibiting the disclosure of information absent advance permission from the CFPB, the proposed rules appear to impose a prior restraint and a content-based restriction on speech. For example, they would prohibit a CID recipient from publicly criticizing the agency for issuing a CID. Even in the context of National Security Letters issued by the FBI—where the governing statute expressly authorizes the FBI to direct third-party recipients not to disclose receipt of the letter and where the governmental interest in national security is considered paramount—courts have rejected such blanket disclosure prohibitions as unconstitutional.[16] In the case of the FTC, Congress has authorized the agency to seek a court order prohibiting a third-party CID recipient from disclosing receipt of a CID for a defined period of time.[17] That legislative scheme, which is notably absent from the Dodd-Frank Act, is intended to account for these First Amendment concerns. The CFPB's proposal, however, does not address this Constitutional issue.

Confidential Supervisory Information—Broader Authority to Disclose

At the same time that the CFPB is seeking to impose limitations on the information that CID recipients can share, it is also proposing to loosen the restrictions on the agency's own sharing of confidential supervisory information. The Dodd-Frank Act expressly authorizes the CFPB to disclose confidential supervisory information to a prudential regulator or other government agency "having jurisdiction over" a CFPB-supervised entity.[18] In its currently-operative rules, the CFPB interpreted this statutory grant of authority as reflecting the limits on the agency's authority to disclose confidential supervisory information to other agencies, and the rules therefore only authorize the CFPB to disclose confidential supervisory information to other agencies that "have jurisdiction over" the party to whom the information relates.[19] The CFPB now proposes to re-interpret this provision of the Dodd-Frank Act to be merely permissive and to not reflect any limitation on the CFPB's authority to disclose confidential supervisory information. According to the CFPB, because Congress did not provide that the CFPB may *only* disclose confidential supervisory information to agencies having jurisdiction over a supervised party, the "better view" is that Congress did not intend the statutory provision to restrict the CFPB's discretion.[20] Accordingly, the CFPB proposes to change its rules to authorize the disclosure of confidential supervisory information to another agency "to the extent that the disclosure of the information is *relevant to* the exercise of the agency's statutory or regulatory authority."[21] This is the same standard applicable to the CFPB's sharing of confidential investigative information.

At the same time, the CFPB is also proposing to expand the definition of "agency" to include foreign regulators as well as non-governmental entities "that exercise governmental authority, such as registration and disciplinary organizations like state bar associations."[22] Coupled with the change described above, this would allow the CFPB to share both confidential investigative information and confidential supervisory information with such regulators and entities so long as the disclosure is "relevant" to the entity's statutory or regulatory authority.

The proposed rules provide little by way of explanation for why this change is needed. The CFPB says only that sharing confidential supervisory information in situations where such information is "relevant" to the receiving agency's exercise of its authority will "facilitate the Bureau's purposes and objectives" and "assist the Bureau in implementing and administering federal consumer financial law in a more consistent and effective fashion" by working "together with other agencies having responsibilities related to consumer financial matters."[23] The CFPB does not, however, provide any actual examples of how it might share confidential supervisory information and how such sharing would help advance its "purposes and objectives." The CFPB also states that the "current rule's restrictions have proven overly cumbersome in application, pose unnecessary impediments to cooperating with other agencies, and otherwise risk impairing the Bureau's ability to fulfill its statutory duties."[24] Again, the CFPB provides no concrete examples of how the current limitations, which as noted above are grounded in the statutory language, have impeded cooperation with other agencies.

The CFPB's current rules already authorize it to disclose confidential supervisory information to law enforcement agencies that have "jurisdiction" over supervised entities. The CFPB does note that its policy regarding disclosure of confidential supervisory information to law enforcement agencies, which it announced in January 2012, remains unchanged.[25] Pursuant to that policy, "the Bureau will not routinely share confidential supervisory information with agencies that are not engaged in supervision" and will "share confidential supervisory information with law enforcement agencies, including State Attorneys General, only in very limited circumstances."[26] The proposed rules, therefore, are apparently intended to authorize the CFPB to provide confidential supervisory information to other, unspecified agencies that do not have any jurisdiction over the supervised institution whose information is to be shared. It is not clear with which additional agencies (other than possibly state bar associations) the CFPB proposes to share confidential supervisory information or how the proposed change will assist in the coordination the CFPB describes.

Comments

The CFPB received over two dozen comments on its proposed rules. Several commentators—including groups as diverse as the ACLU, the American Bar Association's Business Law Section, the U.S. Chamber of Commerce, and several trade associations, as well as House Financial Services Committee Chairman Jeb Hensarling—noted that the proposed rules' restrictions on recipients of CIDs would run afoul of the First Amendment in the manner discussed above.

Even more commentators took issue with the CFPB's proposal to expand the universe of agencies to whom it might disclose confidential supervisory information. In addition to general objections about this proposal, the American Bar Association and several other commentators raised an ancillary concern with the proposed expanded authority to share confidential supervisory information relating to attorney-client privileged information. Specifically, these commentators raised a concern that the CFPB sharing such privileged information—which the CFPB is statutorily authorized to receive without a supervised institution waiving the privilege[27]—may waive the privilege if the information is shared with agencies not covered by 12 U.S.C. § 1821(t). That latter provision expressly provides that when the CFPB (or another specified agency) shares privileged information with other specified agencies, such disclosure shall not constitute a waiver of any privilege. Because the CFPB's proposal would allow the sharing of confidential supervisory information—including privileged information—with entities not covered by Section 1821(t), the sharing of such information may waive the underlying privilege.

The notice and comment process is intended to allow agencies to receive just such input before finalizing rules. It remains to be seen what changes, if any, the CFPB will make to the proposed rules before finalizing them.

Endnotes

1. 12 C.F.R. § 1070.41.
2. 12 C.F.R. § 1070.2(h).
3. 12 C.F.R. § 1070.41.
4. 78 Fed. Reg. 11484, 11484 (Feb. 15, 2013) (emphasis added).
5. 12 C.F.R. § 1070.41(a).
6. 78 Fed. Reg. at 11493 (emphasis added).
7. 12 C.F.R. § 1070.42(b)(2)(i).
8. 12 C.F.R. § 1070.42(b)(2)(ii).
9. CFPB Bulletin 2015-01, Treatment of Confidential Supervisory Information (Jan. 27, 2015).
10. *See, e.g.*, CID issued to Kevin Stricklin, attached as Exhibit A to CFPB Petition to Enforce Civil Investigative Demand, *CFPB v. Stricklin*, No. 1:14-cv-00578-RDB (D. Md.) ("We ask your *voluntary cooperation* in not disclosing the existence of this CID outside your organization, except to legal counsel, until you have been notified that the investigation has been completed. Premature disclosure could impede the Bureau's investigation and interfere with its enforcement of the law.") (emphasis added).
11. 81 Fed. Reg. 58310, 58316 (Aug. 24, 2016).
12. *Id.* NORA letters are the mechanism by which the CFPB informs an investigation target that the staff is considering recommending that charges be instituted. It is similar to a Wells Notice in SEC practice.
13. The CFPB makes this observation by stating that the proposed rules would "provide that recipients of confidential investigative information have the same discretion with respect to disclosing" it as do recipients of confidential supervisory information. *Id.* Such a formulation suggests that under the current rules recipients of confidential investigative information lack discretion to disclose that information. As discussed above, there are strong arguments to conclude that is not the case.
14. 12 C.F.R. § 1070.41(a).
15. *See* http://www.consumerfinance.gov/policy-compliance/enforcement/petitions/. The CFPB describes publication of CIDs in such circumstances as part of its commitment to transparency.
16. *See, e.g., Doe v. Mukasey*, 549 F.3d 861, 876-83 (2d Cir. 2008); *In Re National Security Letter*, 930 F. Supp. 2d 1064, 1073-78 (N.D. Cal. 2013). Aggravating the Constitutional issues inherent in the CFPB's proposal is the lack of any procedures or standards pursuant to which the CFPB would determine whether to allow disclosure in a particular case.
17. See 15 U.S.C. § 57b-2a(c).
18. 12 U.S.C. § 5512(c)(6)(C)(ii).
19. 12 C.F.R. § 1070.43(b)(1).
20. 81 Fed. Reg. at 58317.
21. *Id.* (emphasis added).
22. *Id.* at 58311.
23. *Id.*
24. *Id.*
25. *Id.* at 58318 (citing CFPB Bulletin 12-01 (Jan. 4, 2012)).
26. CFPB Bulletin 12-01 at 5.
27. 12 U.S.C. § 1828(x).

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Employee Benefits in the Trump Administration: What Can Employers Expect?

By David Pratt

I. Introduction.

As this is written, 11 days after the Presidential election, there is considerable uncertainty as to how much, and how fast, the federal rules governing employee benefits, particularly health and retirement benefits, will change. According to a survey taken after the election, 48 percent of employers cite the "large employer" (at least 50 or more employees) mandate to offer health coverage as their primary health care concern. Other areas of concern include prescription drug costs (17 percent), the excise tax (also known as the "Cadillac Tax") on high-cost health plans that is due to take effect in the year 2020 (15 percent), possible limitations on the income and employment tax exclusions for employer-sponsored health care (10 percent), paid-leave laws (8 percent) and employee wellness programs (2 percent).[1]

Despite the uncertainty, employers must plan for the future, handle benefit plan enrollment for 2017, and comply with their obligations under current laws (including the Affordable Care Act, or ACA), unless these laws are changed. Otherwise, these entities risk incurring substantial penalties, particularly for failure to comply with the ACA reporting requirements for the 2016 calendar year.[2]

Health Benefits

Mr. Trump's transition website includes the following statement:

> A Trump Administration will work with Congress to repeal the ACA and replace it with a solution that includes Health Savings Accounts (HSAs), and returns the historic role in regulating health insurance to the States. The Administration's goal will be to create a patient-centered healthcare system that promotes choice, quality and affordability with health insurance and healthcare, and take any needed action to alleviate the burdens imposed on American families and businesses by the law.
>
> To maximize choice and create a dynamic market for health insurance, the Administration will work with Congress to enable people to purchase insurance across state lines. The Administration also will work with both Congress and the States to re-establish high-risk pools—a proven approach to ensuring access to health insurance coverage for individuals who have significant medical expenses and who have not maintained continuous coverage.
>
> The Administration recognizes that the problems with the U.S. health care system did not begin with—and will not end with the repeal of—the ACA. With the assistance of Congress and working with the States, as appropriate, the Administration will act to:
>
> a. Protect individual conscience in health care
>
> b. Protect innocent human life from conception to natural death, including the most defenseless and those Americans with disabilities
>
> c. Advance research and development in health care
>
> d. Reform the Food and Drug Administration, to put greater focus on the need of patients for new and innovative medical products
>
> e. Modernize Medicare, so that it will be ready for the challenges with the coming retirement of the Baby Boom generation—and beyond
>
> f. Maximize flexibility for States in administering Medicaid, to enable States to experiment with innovative methods to deliver healthcare to our low-income citizens[3]

II. The Future of the ACA

Since its enactment in 2010, Congressional Republicans have voted numerous times to repeal the ACA. Throughout his campaign, and after the election, Mr. Trump has said repeatedly that one of his first acts in office will be to "repeal and replace" the ACA. In contrast, however, Mr. Trump has lately taken a liking toward two key provisions of the ACA: the rule that health plans and insurers may not take pre-existing conditions into account and the provision that allows children to be covered by a parent's health plan until age 26.[4]

This creates a fundamental problem of adverse selection. If, as is clearly Mr. Trump's intent, there will no longer be an individual mandate to buy health insurance or an employer mandate to offer insurance, how can health plans and insurers provide affordable health coverage to those who want it? New York and other states that have tried this approach before the ACA found that insurers exited the market in droves.

Even without details, congressional budget analysts and outside health policy experts have estimated the likely impact of dismantling the ACA and replacing it with Trump's health policies. The Congressional Budget Office forecast that, over the coming decade, repealing the law would cause the deficit to grow by $353 billion, while the number of people with insurance would fall by about 24 million. The Rand Corp. has predicted that in 2018 (the first full year of Trump's tenure), his campaign's health plan would add nearly $6 billion to the deficit, primarily by undoing a slowdown in Medicare payments under the law. According to Rand, it also would decrease the number of insured by about 20 million people.[5]

In addition, as many commentators have pointed out, repealing the ACA would not be easy. First, the Republicans do not have a filibuster-proof majority in the Senate. Second, repeal of the ACA, or repeal of the federal subsidies that fund the Medicaid expansion and make it possible for individuals to buy coverage on the exchanges, could cause more than 20 million people to lose coverage. Repeal without replacement would be politically problematic. Vice-President-Elect Pence has suggested that the subsidies would be continued for a transition period, until replacement legislation is enacted,[6] but this would simply kick the problem down the road. In view of recent experience, it is entirely likely that the two parties would not agree on replacement legislation.

There is an alternative: the Republicans could repeal much of the ACA (Speaker Paul Ryan has suggested 85 percent) through budget reconciliation legislation, which requires only a simple majority in both Houses of Congress. However, this could only deal with issues that directly affect the federal budget, and would have to comply with the somewhat arcane procedures and timetable for budget reconciliation legislation. "Republicans in Congress opened the opportunity to use reconciliation to pass their repeal-and-replace plan early in 2016, when they passed a repeal measure (H.R.3762) they knew would be vetoed by Obama. That bill would have ended subsidies for Americans obtaining insurance in an ACA marketplace and federal funding for states expanding their Medicaid programs starting in 2018. It also would have eliminated the penalties for failing to have health insurance and the Cadillac Tax, levied on high-price health plans."[7]

ACA provisions that could be addressed through budget reconciliation legislation include the following:[8]

The individual mandate	IRC section 5000A
The employer mandate	IRC section 4980H
The small business tax credit	IRC section 45R
The premium tax credits	IRC section 36B
Cost-sharing reductions	42 USC section 18071
Medicaid expansion The Cadillac tax	IRC section 4980I
Limits on the use of HSAs, FSAs, HRAs and MSAs	IRC sections 106, 220 and 223
Limit on annual contributions to Health FSAs ($2,600 for 2017)	IRC section 125
Tax deductions for health insurance premiums	IRC section 213
Additional Medicare taxes on high earned income and high investment income	IRC sections 1401, 1411 and 3101

The Obama administration is involved in a number of lawsuits involving the ACA. The Trump administration might simply cease to contest those lawsuits, effectively allowing the plaintiffs to triumph. "If the government withdrew its appeal in *House v. Burwell*, for example, reimbursement to insurers for cost-sharing reduction payments could cease. Indeed, the administration could simply stop paying cost-sharing reduction payments, although this would probably take a rule change. Ending cost-sharing reduction payments would dramatically increase the cost of marketplace participation by insurers and likely lead to many insurers exiting the program. It is possible that beneficiaries or insurers could sue to reinstate the payments, but that would take time, and would likely not happen quickly enough to save the program."[9]

The insurance reform provisions of the ACA cannot be changed through budget reconciliation. A further problem is that the ACA affects every aspect of the health care system. Insurers, hospitals and other providers have invested enormous resources in complying with the Act and adapting the health care delivery process, for instance by forming accountable care organizations. An enterprise of that enormity cannot be reversed on a dime, which suggests the necessity of a lengthy transition process: "the Affordable Care Act contains hundreds of provisions affecting Medicare, program integrity, the health care workforce, biosimilars, prevention, and other issues unrelated to what most Americans think of as 'Obamacare.' Immediate repeal of the ACA and presumably restoring the law that preceded it would likely bring the Medicare program, for example, to a halt until new rules could be written. The ACA is inextricably interwoven into our health care system and is not going away immediately."[10]

The health care industry has invested hundreds of millions of dollars in preparing for the ACA, does not know what to do next, and is worried about a potential financial disaster. "A repeal of the act would mean the loss of millions of customers for insurance companies and uninsured people turning to hospital emergency rooms for basic care [. . .] the industry as a whole made no contingency plans for a Trump victory and does not yet appear to have developed a strategy [. . .] Insurers will feel the loss of customers both in the individual market and under state Medicaid programs. While most are well diversified into other areas of insurance, the Affordable Care Act was seen as a way to forestall the steady erosion in employer-based insurance [. . .] Hospitals, however, are likely to be the biggest losers. Under the law, they agreed to get less money from the government, essentially in exchange for having to cover fewer uninsured people."[11]

Mr. Trump could drop the administration's appeal in *U.S. House of Representatives v. Burwell*,[12] in which House Republicans charged that the Obama administration was unconstitutionally spending money that Congress had not formally appropriated, to reimburse insurers providing coverage to policyholders earning between 100 and 250 percent of the federal poverty level. In May, 2016, Judge Collyer ruled for the House, but stayed the decision, pending appeal. "Even those who support the law say that mismatch would effectively shut down the health exchanges, because insurers would simply drop out."[13]

As a result of the Supreme Court's decision in the Hobby Lobby case,[14] and widespread opposition to the mandated coverage of contraceptives, it is almost certain that Mr. Trump will instruct his Secretary of Health and Human Services not to enforce the requirement and to amend the regulations accordingly. His administration will almost certainly cease to defend the pending contraceptive cases.

Another way Mr. Trump could undermine the ACA would be by simply not enforcing certain provisions, such as the individual mandate.

III. Effect on Employer Health Plans

Turbulence in the health insurance market is likely to have an adverse effect on employers who maintain health plans, and make it much more difficult for them to design appropriate coverage and avoid significant cost increases. Despite the large numbers of Americans who are covered by other types of health insurance (Medicaid, Medicare, the Children's Health Insurance Program and the Veterans Administration), the key component is employer-sponsored health coverage. Employer-sponsored plans cover more than half of the non-elderly population; approximately 150 million non-elderly people in total. And the ACA has been much less successful in controlling health care inflation than in expanding coverage.

In 2016, the average annual premiums for employer-sponsored health insurance are "$6,435 for single coverage and $18,142 for family coverage [. . .] Premiums for family coverage have increased 20% since 2011 and 58% since 2006. Average premiums for high-deductible health plans with a savings option (HDHP/SOs) are considerably lower than the overall average for all plan types for both single and family coverage, at $5,762 and $16,737 respectively. These premiums do not include any employer contributions to workers' health savings accounts or health reimbursement arrangements [. . .] the share of covered workers with HDHP/SOs has grown eight percentage points over the last two years; this change in enrollment has reduced the growth in single and family premiums by roughly a half percentage point each of the last two years. Premiums vary significantly around the averages for both single and family coverage, reflecting differences in health care costs and compensation decisions across regions and industries."[15]

Prescription Drug Costs

According to the Centers for Medicare and Medicaid Services, health care costs increased by 5.3 percent in 2014, but "[r]etail prescription drug spending accelerated in 2014, growing 12.2 percent to $297.7 billion [. . .] The rapid growth in 2014 was due to increased spending for new medications (particularly for specialty drugs such as hepatitis C), a smaller impact from patent expirations, and brand-name drug price increases. Private health insurance, Medicare, and Medicaid spending on prescription drugs all accelerated in 2014."[16]

As a candidate, Mr. Trump said that his administration would rein in high drug costs. His presidential transition website does not specifically mention this issue. "President-elect Trump proposed addressing prescription drug costs by moving drugs into the marketplace faster to increase competition and reduce costs. Lawmakers have supported this goal, but it is not clear whether they would include prescription drug proposals in legislation to repeal and replace the ACA, address the issue in separate legislation or take another path."[17]

IV. The Tax Treatment of Employer-Sponsored Health Coverage

In 2015, a Republican task force proposed capping the income and employment tax exclusion "at a level that would ensure job-based coverage continued unchanged for the vast majority of plans."[18]

The 40 percent excise tax (the "Cadillac Tax") on high-cost health plan coverage is highly unpopular with employers. Originally scheduled to take effect in 2018, the effective date has been postponed to 2020. The concern for employers is what new sources of revenue will take its place. One obvious candidate is the income and employment tax exclusion for employer-sponsored health care, which is one of the largest tax expenditures in the federal budget. "The full exclusion from income for employer-sponsored health coverage and benefits is always in jeopardy in any tax reform proposal. Some form of cap on the exclusion has been discussed on both sides of the aisle for years. It's a likely revenue-raising option. Furthermore, if individuals can fully deduct individual premium expenses, the tax incentives for most Americans to receive coverage through their employer begin to diminish."[19]

If alternative sources of coverage under the ACA, primarily through the exchanges and Medicaid expansion, cease to be available, employers may feel additional pressure to expand health plan coverage or to continue providing coverage, despite the ever-increasing cost and complexity of providing a plan that is effective and affordable.

"If alternative sources of coverage under the ACA, primarily through the exchanges and Medicaid expansion, cease to be available, employers may feel additional pressure to expand health plan coverage or to continue providing coverage, despite the ever-increasing cost and complexity of providing a plan that is effective and affordable."

Fifty-six percent of firms "offer health benefits to at least some of their workers, similar overall to percentages in recent years [. . .] Even when firms do offer health benefits, not all of their workers are covered there [. . .] In firms that offer coverage, an average of seventy-nine percent of workers are eligible for the health benefits offered by the firm, and of those eligible, seventy-nine percent take up the firm's offer, resulting in sixty-two percent of workers in offering firms having coverage through their employer. If we look across workers both in firms that offer and those that do not offer health benefits, fifty-five percent of workers are covered by health plans offered by their employer. Each of these percentages are [sic] similar to 2015 figures. Over the longer term, however, the percentage of workers in all firms covered by a health plan from their employer has fallen from fifty-nine percent in 2006 and fifty-eight percent in 2011 to fifty-five percent in 2016."[20]

Like retirement plan coverage, health plan coverage correlates with the size of the employer, age, union status and higher income. Like most tax benefits, the bulk of the very large tax expenditure goes primarily to upper-income taxpayers, so the present exclusion is vulnerable to attack from both ends of the political spectrum.

V. Paid Leave and Minimum Wage Laws

Arizona and Washington recently became the latest states to require paid sick leave. Seven states, 29 cities, two counties, and Washington D.C. now have paid sick leave laws, and the requirements vary widely.[21]

"President-elect Trump proposed six weeks of paid leave following childbirth for women whose employers do not offer paid maternity leave benefits. Congress generally has not supported paid leave legislation, so it is not clear whether or when House and Senate leaders will act on the proposal. In the absence of federal action, states and cities have enacted a wide range of paid family and paid sick leave law, and that trend seems likely to continue."[22]

Similarly, in several states voters have approved or legislatures have enacted increases in the minimum wage, which vary widely in their details.[23]

"This trend is expected to continue, and could intensify if Congress and the administration do not enact federal legislation on these and other issues. In addition, the potential for ACA repeal could trigger renewed state discussions about health care reform. Employers should prepare for an increasing patchwork of state requirements, and possibly for an increase in the number of benefits and workforce-related policies receiving attention at the state and local level."[24]

VI. Employee Wellness Programs

Many employers offer wellness or health promotion programs to help employees improve their health and avoid unhealthy behaviors. "Among large firms with an incentive for completing wellness programs, incentives include: lower premium contributions or cost sharing (thirty-four percent of firms); cash, contributions to health-related savings accounts, or merchandise (seventy-six percent of firms); some other type of incentive (fourteen percent of firms)."[25]

However, wellness programs have recently come under attack from the EEOC (which took positions at odds with the Obama administration) and advocacy groups such as AARP. Wellness programs are seen by most employers as an important tool in controlling health care cost increases, but it is essential for employers to have clear guidance that they can follow.

VII. Retirement Benefits

As of June 30, 2016, total U.S. retirement plan assets were $24.5 trillion, more than twice the $11.6 trillion reported for 2000. That is a very large amount of money—significantly larger than the Gross Domestic Product (GDP) of the United States or China, the world's two largest economies; more than 30 times the market value of the world's most valuable company, Alphabet, the parent of Google; and more than 300 times the net worth of the world's richest individual, Bill Gates. The largest single component of retirement plan assets is the $7.5 trillion held in individual retirement accounts (IRAs), which is considerably more than the $4.9 trillion held in 401(k) plans. The Obama administration, the Government Accountability Office and pension experts (among others) have expressed concern in recent years regarding the integrity of the IRA rollover process and the quality of the investment advice retail investors receive in connection with retirement asset rollover and investment decisions.[26]

Mr. Trump has said very little about retirement plans, except that (unlike many Republicans) he does not want to change Social Security. "Trump made clear that he doesn't plan to cut Social Security benefits, but he didn't sound enthusiastic about plans to expand the federal program, as more and more Democrats have proposed. Trump has also proposed large tax cuts. If they create wide deficits, as analysts have predicted, that could put long-term financial pressure on the Social Security program, which faces a shortfall in eighteen years when the baby boom generation is fully retired."[27]

However, many of his supporters long for the demise of the Department of Labor's (DOL) so-called fiduciary rule, which imposes expanded fiduciary obligations on investment advisers to retirement plans and IRAs. The rule becomes effective in April 2017, and it is difficult to see how repeal legislation or new DOL regulations could take effect by that date. Simple non-enforcement by DOL would be easy, but would not stifle the private lawsuits that are available under the rule.

The rule, and its related exemptions, is exceptionally complex, and repeal would be consistent with Mr. Trump's avowed aim to reduce government regulation. However, although a majority of financial advisers hate the DOL rule, some major players (e.g., Merrill Lynch) have expressed support and, having invested millions of dollars in compliance, are not anxious to reverse course. In addition, it is not clear that repeal is good for retirement plan sponsors: over the last few years, there have been numerous large class action judgments and settlements (including substantial attorney fee awards) against plan sponsors, and doing business with advisers who follow the rule may be important in establishing that the sponsor has complied with its fiduciary duties under ERISA.

Many observers, including President Obama and the General Accountability Office, have expressed great concern over the fact that many individuals do not have access to a retirement plan at work and, even if they do, typically have woefully inadequate savings for retirement. It seems unlikely that the Trump administration will continue the Obama administration's energetic efforts to expand availability and coverage. The favorable tax treatment afforded to retirement plans is a large tax expenditure and could be cut back to help pay for other parts of the administration's program. Further, if income taxes are, as promised, reduced significantly for higher income taxpayers, business owners may be less willing to sponsor retirement plans for their employees.

VIII. Conclusion

Employee benefits are a significant expense for most businesses of any size, and planning for the future—always difficult in this area—has just become a lot more complex. For now, businesses may have no real alternative except planning on a relatively short-term basis, and trying to maintain flexibility to change benefit programs in response to changing conditions.

> *"The largest single component of retirement plan assets is the $7.5 trillion held in individual retirement accounts (IRAs), which is considerably more than the $4.9 trillion held in 401(k) plans."*

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Recent Employment Laws Impacting Private Employers in New York

By Sharon Parella

Introduction

Under the federal Defend Trade Secrets Act of 2016, employers may now pursue claims for misappropriation of trade secrets in federal district courts. This new law, however, contains various immunity provisions that generally exempt from liability those employees who disclose trade secrets when making reports of suspected violations of law to government officials and/or commence workplace retaliation lawsuits based on their having made such reports. Furthermore, the new law limits the scope of damages available to employers who do not notify their employees about the immunity provisions in accordance with the law. In addition, the New York City Council has introduced a proposed bill that would, among other things, prohibit retaliation against employees who seek flexible working arrangements and require employers to make temporary schedule changes for employees in certain emergency situations. Finally, the New York City Commission on Human Rights has released a new Legal Enforcement Guidance concerning discrimination on the basis of pregnancy, and the New York City Commission on Human Rights and New York State have announced comprehensive campaigns intended to eradicate discrimination and bias.

A summary of these laws, guidelines and campaigns is set forth below.

Federal Law

Defend Trade Secrets Act of 2016

Under the federal Defend Trade Secrets Act of 2016 ("DTSA"), effective May 11, 2016, owners of trade secrets (*i.e.*, private companies and individuals) can now take advantage of a federal civil cause of action for theft of trade secrets. Specifically, no longer limited to state courts, aggrieved companies and individuals may institute claims for theft of trade secrets in federal district courts, seeking damages, injunctive relief, attorney fees and, in extraordinary circumstances, *ex parte* seizure of property to prevent public disclosure of trade secrets that would result in immediate and irreparable injury.

Significantly, while providing this new cause of action for theft of trade secrets, the DTSA nevertheless generally exempts from liability (i) "whistleblowers" who disclose trade secrets in confidence to federal, state or local government officials or to attorneys solely for the purpose of reporting suspected violations of law, (ii) individuals who disclose trade secrets in a complaint or other document *filed under seal* in a lawsuit or like proceeding, and (iii) individuals who disclose trade secrets to their attorneys and/or in court filings *made under seal* for claims of workplace retaliation for reporting suspected violations of law. These DTSA provisions provide immunity from both civil actions and criminal charges under both federal and state laws relating to the disclosure of trade secrets. Accordingly, in order to receive exemplary damages and attorneys' fees (as described below), the DTSA requires that any agreements between employers and employees (or independent contractors and consultants) entered into on or after May 11, 2016 and containing provisions concerning use of trade secrets and other confidential information must contain notice of the DTSA's foregoing immunity provisions. The requisite notice may be satisfied by cross-referencing to the employer's policy for reporting suspected violations of law, such as a policy contained in an employee handbook or code of conduct, provided that the policy includes sufficient information about the immunity provisions.[1]

Under the DTSA, a trade secret is defined as one that is "related to a product or service used in, or intended for use in, interstate or foreign commerce."[2] Any claim under the DTSA must be brought within three years of the date that the theft was or reasonably should have been discovered, and continuing misappropriation constitutes a single claim of theft.[3]

As set forth above, available remedies under the DTSA are (i) an injunction to prevent any actual or threatened misappropriation (provided, among other things, that the court does not prevent a prevent a person from entering into an employment relationship and that any conditions placed on such employment are based on evidence of threatened misappropriation, (ii) affirmative actions to protect the trade secret, (iii) damages for actual loss caused by the theft of the trade secret, (iv) damages for any unjust enrichment that is not addressed by computing damages for actual loss, (v) in lieu of damages measured by other methods, imposition of liability for a reasonable royalty for the disclosure or use of the trade secret, (vi) for willful and malicious theft, exemplary damages in an amount not more than two times the amount of damages awarded for actual loss and unjust enrichment, and (vii) *ex parte* seizure of property to prevent public disclosure of trade secrets that would result in immediate and irreparable injury. Moreover, if the theft claim is made in bad faith (which may be established by circumstantial evidence), a motion to terminate an injunction is made or opposed in bad faith or the trade secret was willfully and maliciously appropriated, the court may award reasonable attorneys' fees to the prevailing party.[4]

In addition, except for its immunity provisions, the DTSA does not preempt and is in addition to state laws protecting against theft of trade secrets.[5]

Legislation Proposed by the New York City Council

Flexible Work Arrangements

Recently, the New York City Council introduced a bill intended to protect employees seeking to obtain flexible work arrangements.[6] If enacted, all employers in New York City (i) will be prohibited from discriminating against an employee who requests a "flexible work arrangement," (ii) at least once each calendar quarter, must engage in a "interactive process" with an employee who makes a flexible work arrangement request, and (iii) must respond to an employee's request in writing and in good faith within fourteen days. If the employee's request is denied, the employer's written response must provide an explanation for the decision and whether the request was inconsistent with business operations. Employees must submit their requests in writing.

> *"Under the bill, a flexible work arrangement is defined as 'a work structure that alters the employer's regular terms and conditions of employment with respect to work schedule, duties or location.'"*

Under the bill, a flexible work arrangement is defined as "a work structure that alters the employer's regular terms and conditions of employment with respect to work schedule, duties or location." This is meant to include, among other things, requests for a modified work schedule, changes in days or work or start and end times for the work day, part-time employment, working from home or another location and reductions or changes in work duties.

In addition, the bill would entitle employees to receive temporary changes in their work schedules up to four times each year and for one business day due to (i) a caregiving emergency involving a family member, (ii) a personal health emergency when the employee does not have sick leave available due to not having yet earned it or having exhausted, or paid leave is inapplicable to the situation, and (iii) the employee or family member suffering a family offense matter (*i.e.*, criminal acts or threats of criminal acts between spouses or former spouses, parents and children or members of the same family or household), a sexual offense or stalking. In any of the foregoing circumstances, the employee must notify his or her employer or direct supervisor as soon as becoming aware of the need for the change, but is not required to do so in writing.

Finally, the proposed bill would require employers to provide every employee who is expected to work hours on a schedule determined by the employer with his or her expected work schedule in writing and upon hire; such written schedule must include the hours and times that, as well as locations where, the employee is expected to work.

Campaigns Against Discrimination and Bias

New York City Commission on Human Rights

Recently, the New York City Commission on Human Rights ("NYCCHR") announced several ongoing campaigns against discrimination in the workplace. First, the NYCCHR issued a comprehensive Legal Enforcement Guidance on Discrimination on the Basis of Pregnancy which, among other things, defines violations of pregnancy protections, and provides specific examples of when and how employers must make accommodations for employees based on pregnancy, childbirth or a related medical condition.[7] Under the Guidance, examples of violations by employers include:

(i) Failing to hire an applicant who is otherwise qualified because she is pregnant;

(ii) Joking about a pregnant employee's weight gain, and responding to the employee's complaints about the jokes by stating that being pregnant is causing the employee to be overly sensitive and emotional;

(iii) Failing to offer a promotion to a pregnant employee who is otherwise qualified based on the assumption that she will not return to work after childbirth; and

(iv) Electing not to assign a pregnant employee to a new project based on the assumption that she will be distracted by the pregnancy.[8]

With respect to reasonable accommodations for pregnancy, childbirth and related medical conditions, employers must engage in cooperative dialogues with employees who request such accommodations; they must communicate in good faith and "in an open and expeditious manner, particularly given the time-sensitive nature of these requests."[9] Examples of reasonable accommodations include changes in work schedules, additional water, snack and/or bathroom breaks or breaks to rest, allowing the employee to eat at her work station, physical modifications to a work station (such as the addition of a fan or a seat), light duty or transfer to an alternative position.

In addition, the NYCCHR and Mayor Bill de Blasio announced a government-led citywide ad campaign affirming every New Yorker's right to use the bathroom consistent with the individual's gender identity or expression, regardless of the sex assigned to the individual at birth. The campaign includes ads and videos featuring transgender New Yorkers, and emphasizes significant violations of transgender gender non-conforming employees being denied access to appropriate bathrooms at work.[10]

Finally, the NYCCHR and Mayor de Blasio's Community Affairs Unit and Office of Immigrant Affairs announced a series of ongoing events and a social media campaign intended to promote respect, support and understanding of anti-discrimination protections for New York City's Muslim community. The campaign includes a digital ad program led by the NYCCHR, appearing on social media with the hashtag #IamMuslimNYC, and will direct viewers to an online link to resources, events and calls to action, among numerous other activities. Furthermore, in spring 2017, the NYCCHR will launch a citywide public information and integrated marketing campaign on combating xenophobia and embracing religious diversity in New York City. Among the violations delineated by the NYCCHR are "refusing to hire or promote because of [his or her] faith, assigning an employee to a non-customer facing role because of religious attire, or treating an employee differently because of [his or her] beliefs."[11] Moreover, the NYCCHR emphasized that "[e]mployees have the right to request reasonable accommodations to observe religious attire in the workplace" (such as growing a longer beard or wearing turbans, hijabs, headscarves and kufis), and "the right to request time off to observe a religious holiday or ritual (such as prayer in the middle of the day) and can work with their employer[s] to reach an arrangement, such as paid leave, leave without pay, or the ability to make up missed time at a later date."[12]

New York State

On November 15, 2016, following a recent increase in reports of discrimination and bias-motivated threats, harassment and violence, Governor Andrew Cuomo launched a toll-free hotline to report incidents of discrimination and bias (including in employment) in New York State. Among other things, the hotline is intended to bolster the protections afforded to New York State residents by the New York State Division of Human Rights' complaint filing process pursuant to the New York Human Rights Law.[13]

In addition to instituting the hotline, Governor Cuomo has sent a letter to the State Education Department "requesting schools to hold trainings to combat intolerance and safeguard New York's students," and also directed multi-agency investigations into alleged hate crimes.[14]

The hotline is at (888) 392-3544, and is available from 9:00 a.m. to 5:00 p.m. Monday through Friday.

Endnotes

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10. NYC Human Rights website, located at www1.nyc.gov.
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13. www.governor.ny.gov ("Governor Cuomo Announces Statewide Hotline to Report Incidents of Bias and Discrimination").
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Standard New York Choice of Law Provisions May Apply Foreign Laws to Bar Claims

By William J. Hine and Sevan Ogulluk

Parties in countless commercial transactions include provisions calling for their agreements to be "governed by, construed and enforced in accordance with laws of the State of New York."[1] But recent decisions by New York's courts illustrate how such standard provisions often pose as traps for the unwary, and could actually lead to the unintended and counterintuitive application of foreign laws to a resulting dispute and extinguish claims as untimely.

Specifically, although parties may agree to a broadly drawn choice of law clause applying New York's substantive and procedural laws, a claim filed by a party that is squarely within New York's statute of limitations period may nonetheless be time-barred. The "procedural" limitations period of a sister state or a foreign country may apply while, at the same time, New York's "substantive" law applies to the same dispute (per agreement). This is the case even where the parties are contractually bound to litigate in New York courts. And, as if that weren't confusing enough, drastically different limitations periods may apply depending on the nature of the claim, which of the contracting parties is suing, and where they are located.

Moreover, clever parties wishing to prospectively contract their way around these results may be unable to do so. So much for predictability, upholding the parties' intent and encouraging them to use New York courts as their forum for dispute resolution. All thanks to the interplay of New York's "borrowing statute" and confusing jurisprudence about choice-of-law provisions.

The "Borrowing" Statute

Figuring out the statute of limitations periods applicable to potential disputes is not as straightforward as it appears. Practitioners often assume that courts will apply the limitations periods of the jurisdictions in which they sit. But pursuant to so-called "borrowing statutes" of New York and other states, courts often apply limitations periods that are drastically different (and usually far shorter) than the periods in their home states (and in cases involving choice of law clauses in agreements, what the contracting parties intended).

Borrowing statutes, like New York's, require a court to "borrow" or apply, under certain circumstances, the statute of limitations of another jurisdiction. These borrowing statutes have generally been enacted to prevent forum shopping by non-resident plaintiffs who come to (in this case) New York to take advantage of more favorable limitations periods than available to them elsewhere.[2] Under these circumstances, courts will generally evaluate a plaintiff's claims under the statute of limitations of the plaintiff's home jurisdiction, and apply the shorter period pursuant to New York's borrowing statute, Civil Practice Law and Rules § 202, to bar claims. That statute—which has remained substantially unchanged for well over a century—provides:

> An action based upon a cause of action accruing without the state cannot be commenced after the expiration of the time limited by the laws of either the state or the place without the state where the cause of action accrued, except that where the cause of action accrued in favor of a resident of the state the time limited by the laws of the state shall apply.[3]

In sum, New York's borrowing statute gives preferential treatment to residents, while requiring that a claim brought by a non-resident on a cause of action accruing outside of the state be timely under the law of both New York and the jurisdiction where the cause of action accrued. Thus, if the plaintiff is a New York resident, New York's own statute of limitations generally applies.[4] Disputes that involve foreign (i.e., non-New York) parties, however, may trigger New York's "borrowing" statute which, in turn, may determine the applicable statute of limitations.

Broad Choice-of-Law Provisions May Not Preclude "Borrowing"

The borrowing statute analysis is complicated with the interplay of contractual choice-of-law and forum selection clauses, leading to anomalous results and warranting particular attention. Recent decisions emphasize that even where contracting parties agree to apply New York law to their dispute and agree to a forum selection clause requiring them to litigate in New York, they may still find themselves locked into the borrowing statute and therefore subject to an entirely different limitations period which may unexpectedly bar their claims. The analysis turns largely on the citizenship of the litigants and the location where the claim accrued.

New York's intermediate appellate court recently addressed these points in *2138747 Ontario, Inc. v. Samsung C & T Corp.*[5] That case involved a non-disclosure agreement (NDA) signed by five companies based in multiple jurisdictions, which included a familiar choice-of-law clause requiring it to be "governed by, construed and enforced in accordance with the laws of the State of New York."[6] The Ontario-based plaintiff sued, in New York, defendants based in New Jersey and Korea for breach of the NDA. The alleged breach occurred in 2009, but the action was filed in 2014. Although the claim would have been timely under New York's six-year limitations period, New York's borrowing statute applied Ontario's two-year limitations period instead, rendering plaintiff's claims time-barred. In a unanimous decision, the *Ontario* appellate court held that "a broadly drawn contractual choice-of-law provision" providing "for the agreement to be 'governed by, construed and enforced' in accordance with New York law," does not "preclude the application of New York's borrowing statute . . . ."[7] It explained that "[t]he borrowing statute is considered a [procedural] statute of limitations provision and not a [substantive] choice-of-law provision."[8] It emphasized that although choice-of-law provisions generally do not encompass procedural issues, use of the word "enforced" in the provision of the NDA required application of New York procedural law, of which "the borrowing statute is itself a part . . . ."[9]

This treatment of the borrowing statute is to be distinguished from other recent decisions implicating the state's "substantive" statutory choice of law rules. In this latter context, the New York Court of Appeals has reiterated that when parties contract for a particular substantive law to apply, courts need not follow the state's statutory choice-of-law directive and may simply apply the parties' selected substantive law. In *IRB-Brasil Resseguros, S.A. v. Inepar Investments, S.A.*[10] the "Court held that, where parties include a New York choice-of-law clause in a contract, such a provision demonstrates the parties' intent that courts not conduct a conflict-of-laws analysis."[11] The Court therefore did not engage in such analysis since "to find. . .that courts must engage in a conflict-of-laws analysis despite the parties' plainly expressed desire to apply New York law would frustrate the Legislature's purpose of encouraging a predictable contractual choice of New York commercial law and, crucially, of eliminating uncertainty regarding the governing law."[12] Taking this logic a step further in *Ministers & Missionaries Ben. Bd. v. Snow*[13] the Court of Appeals held that a New York choice of law clause "obviates the application of both common-law conflict-of-laws principles and statutory choice-of-law directives, unless the parties expressly indicate otherwise."[14] The Court of Appeals' rationale for applying a borrowing statute differently from a substantive choice-of-law statute is that while the latter is simply a codification of New York common law principles on conflict of laws, the former is a statute of limitations. This distinction reflects the competing public policy concerns of preventing forum shopping, while also providing certainty and encouraging commercial parties to choose New York law.

> *"In* Ministers & Missionaries Ben. Bd. v. Snow, *the Court of Appeals held that a New York choice of law clause 'obviates the application of both common-law conflict-of-laws principles and statutory choice-of-law directives, unless the parties expressly indicate otherwise.'"*

Contracting Around Borrowing Statutes May Prove Difficult

Notably, applying the borrowing statute to the facts of *Ontario* results in the application of four different statutes of limitation to claims brought by parties to the NDA, who were based in Korea, New Jersey, New York, and Ontario. This is clearly not the result envisioned by these contracting parties, who no doubt strived for uniformity and predictability.

Contracting parties wishing to sidestep borrowing statutes and avoid these headaches may find it difficult to do so. Indeed, the appellate court in *Ontario* suggested that parties may not be able to lawfully contract around New York's borrowing statute, but left that question open. In the wake of the uncertainty that is now occasioned by use of choice-of-law provisions, parties should consider some practical issues while negotiating their agreements, especially in complex transactions where parties are based and claims may accrue in multiple jurisdictions.

First, although the court's decision in *Ontario* stressed that use of the word "enforced" in the NDA's choice-of-law clause signaled the parties' intention to apply New York's procedural law (and therefore the borrowing statute), the omission of that word would not necessarily have rendered a different result. The court could have applied New York's borrowing statute (and Ontario's limitations period) even in the absence of the agreement since "the plaintiff is a nonresident alleging an economic claim that took place outside of New York, the time limitations provisions in the borrowing statute apply, *regardless of* whether the parties' contractual choice-of-law agreement can be broadly construed to include the application of New York's procedural, as well as substantive law."[15] Thus, stripping words like "enforced" or "procedural" from standard provisions such as the one used in the *Ontario* NDA will not avoid New York's borrowing statute, which applies even in absence of agreement. Indeed, the whole point of the statute is to keep at bay a forum-shopping plaintiff not bound by any agreement (a policy goal which is now arguably turned on its head with its application to contracting parties such as those in *Ontario*).

Drafters seeking predictability and uniformity may also wish to specify or modify limitations periods in their contract. But such efforts may also prove difficult, as New York courts have long recognized that "[b]ecause of the combined private and public interests involved, individual parties are not entirely free to waive or modify the statutory defense."[16] For example, parties may wish to tailor choice-of-law provisions to expressly provide that the parties agree to apply New York's six-year statute of limitations to their contract-based disputes. But the court in *Ontario* raised the specter that such provisions could be considered "an unenforceable extension of the otherwise applicable statute of limitations."[17] That is because, under New York law, an agreement to waive or extend the statute of limitations for contract claims made in advance and before a claim has accrued is generally unenforceable pursuant to section 17-103[1] of the General Obligations Law, which requires such agreements to be adopted after the cause of action has accrued.[18] Thus, using the facts in the *Ontario* case to illustrate the point, such a provision applying New York's six-year period may be held unenforceable since it could be viewed as impermissibly "extending" Ontario's two year limitations period, made applicable by the borrowing statute.

By contrast, New York does allow for parties to agree to shorten limitations periods.[19] And where the limitations period is reduced, New York courts will enforce it, as long as the shortened time period is reasonable.[20] This standard is context-dependent but is generally met when "the plaintiff had a reasonable opportunity to commence its action within the period of limitation."[21] In the context of commercial contracts a shorter limitations period that nevertheless gives each party the reasonable opportunity to bring suit is more likely to be enforceable (at least under New York law). Although courts may, on occasion, be reluctant to enforce provisions shortening the time to sue, contracts routinely include provisions shortening the time within which a party may file a lawsuit.

Another possible alternative would be to specify application of the limitations period of a jurisdiction other than New York. Thus, parties could choose New York substantive law, and then add another provision specifying that the law of some other state would determine the applicable limitations period. For good measure, they may even specify that "none of the provisions of Article 2 of New York's Civil Practice Laws and Rules shall apply to any action arising out of this agreement." Given New York's policy favoring enforcement of the parties' choice of law, it is likely that such a provision would be enforced, so long as it was not deemed counter to New York public policy.[22]

But parties wishing to embrace the laws of other jurisdictions to escape the labyrinth of New York's rules on limitations periods may find themselves in similar positions. First, many states have borrowing statutes similar to New York's. For example, the borrowing statute in Delaware—a common corporate domicile and favored forum for commercial litigation—directs its courts to compare the relevant limitations periods in Delaware with the limitations period in the state in which the cause of action arose, and then apply the shorter period.[23] Indeed, the court in *Ontario* noted that even foreign jurisdictions (including Ontario) may have similar statutes.[24] Yet, other jurisdictions may have unique borrowing statutes that may lead to opposite and even more unconventional results. Oklahoma's borrowing statute, for example, requires courts in that state to compare the relevant statute of limitations in Oklahoma with those in the jurisdiction in which the claim accrued and apply the *longer* period, an approach that runs counter to traditional borrowing statutes like those found in Delaware and New York. [25] And Virginia's borrowing statute applies only to breach of contract actions, which can result in cases where a non-contract claim is governed by Virginia's limitations period, while a contract-based claim is governed by another state's shorter limitations period.[26]

Second, many other states also have statutes limiting parties' freedom to modify limitations periods. For example, Arizona, Texas, Washington, Vermont and other states have statutes that set minimum time periods applicable to efforts by contracting parties to shorten the time to sue.[27] And some other states refuse to enforce any agreements shortening applicable limitations periods.[28] Clearly, then, parties cannot avoid these issues altogether by simply circumventing New York law.

Conclusion and Practical Considerations

How and to what extent choice of law provisions are given effect across various jurisdictions is a critical consideration during contract negotiations, especially for transactions involving multi-jurisdictional parties and the prospect of litigation. Given that the application of a borrowing statute may result in the unexpected outright dismissal of a case, it is important for parties to understand the implications choice-of-law and forum selection clauses may have in the context of their specific transaction, should litigation arise. Efforts to contract around borrowing statutes such as New York's may not be successful (and may even run afoul of other statutes). Moreover, not all states have borrowing statutes, and not all are uniform. Evaluating litigation options prospectively will require detailed analysis of issues such as the claims involved, the applicable limitations periods in all relevant jurisdictions, where claims will be deemed to have accrued, and the citizenship of parties. And when the likelihood of litigation does arise, parties need to be vigilant in analyzing the limitations periods of the jurisdictions implicated, considering the possibility that they may be required to bring claims earlier than they might otherwise have expected.

Endnotes

1. *2138747 Ontario, Inc. v. Samsung C & T Corp.*, 39 N.Y.S.3d 10, 12 (N.Y. App. Div. 2016).
2. *Global Fin. Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 528 (1999).
3. CPLR 202 (McKinney).
4. If a New York plaintiff has secured its claim through an assignment from a foreign party, however, a court may apply the borrowing statute and cause the assignee's claims to be governed by the limitations period in the assignor's home state. *Portfolio Recovery Assocs. v. King*, 14 N.Y.3d 410, 416-18 (2010).
5. 39 N.Y.S.3d 10 (N.Y. App. Div. 2016).
6. *Id.* at 11.
7. *Id.*
8. *Id.* at 13.
9. *Id*. at 14.
10. 20 N.Y.3d 310 (2012).
11. *Ministers & Missionaries Ben. Bd. v. Snow*, 26 N.Y.3d 466, 468 (2015), *reargument denied*, 26 N.Y.3d 1136 (2016).
12. 20 N.Y.3d at 316.
13. 26 N.Y.3d 466 (2015).
14. *Id.* at 468.
15. 39 N.Y.S.3d at 11.
16. *John J. Kassner & Co., Inc. v. City of New York*, 46 N.Y.2d 544, 550 (1979).
17. 39 N.Y.S.3d at 13.
18. Section 17-103[1], which prescribes the exclusive method of extending or waiving the statute of limitations, provides in pertinent part: "A promise to waive, to extend, or not to plead the statute of limitations applicable to an action arising out of a contract . . ., if made after the accrual of the cause of action and made . . . in a writing signed by the promisor . . . is effective . . . in an action or proceeding commenced within the time that would be applicable if the cause of action had arisen at the date of the promise, or within such shorter time as may be provided in the promise." *See Kassner*, 46 N.Y.2d at 552 (contractual clause could not extend statute of limitations because it was adopted before the cause of action on the contract had accrued).
19. CPLR 201: "An action, including one brought in the name or for the benefit of the state, must be commenced within the time specified in this article unless a different time is prescribed by law or a shorter time is prescribed by written agreement. No court shall extend the time limited by law for the commencement of an action."
20. *See Kassner*, 46 N.Y.2d at 550-51 ("The parties may cut back on the Statute of Limitations by agreeing that any suit must be commenced within a shorter period than is prescribed by law. . . . Thus, an agreement which modifies the Statute of Limitations by specifying a shorter, but reasonable, period within which to commence an action is enforceable . . . provided it is in writing (CPLR 201)") (internal citations omitted).
21. *Exec. Plaza, LLC v. Peerless Ins. Co*., 22 N.Y.3d 511, 519 (2014).
22. *See, e.g.*, *Portfolio Recovery Assocs., LLC v. King*, 14 N.Y.3d 410, 416 (2010) for the proposition that a choice of law provision can encompass the limitations period if there is express intention to do so in the parties' agreement.
23. *See* 10 Del Ch. 8121: "Where a cause of action arises outside of this State, an action cannot be brought in a court of this State to enforce such cause of action after the expiration of whichever is shorter, the time limited by the law of this State, or the time limited by the law of the state or country where the cause of action arose . . . . Where the cause of action originally accrued in favor of a person who at the time of such accrual was a resident of this State, the time limited by the law of this State shall apply."
24. 39 N.Y.S.3d at 15.
25. *See Consolidated Grain & Barge v. Structural Sys.*, 212 P.3d 1168, 1174 (Okla. 2009) (recognizing Oklahoma as having "a borrowing statute with the opposite effect of most borrowing statutes that select the earliest time bar").
26. *See Hansen v. Stanly Martin Cos*., 266 Va. 345, 352 (Va. 2003) (Virginia borrowing statute, Va. Code Ann. § 8.01-247 (West), resulted in application of Maryland limitations period to breach of contract claims brought in Virginia based on a contract that applied Maryland substantive law. However Virginia limitations period applied to tort claims arising out of the same operative facts).
27. *See, e.g., W.J. Kroeger Co. v Travelers Indem. Co*., 541 P.2d 385, 387 (Ariz. 1975) ("A.R.S. s 20-1115 provides that no insurance policy operative in this state shall contain a condition limiting the time within which an action may be brought to a period of less than two years for this type of policy"); Tex. Civ. Prac. & Rem. Code Ann. §16.070(a) ("a person may not enter a stipulation, contract or agreement that purports to limit the time in which to bring suit. . .to a period shorter than two years. A stipulation, contract, or agreement that establishes a limitations period that is shorter than two years is void in this state."); *Stellar J. Corp. v. Argonaut Ins. Co*., No. 3:12-CV-05982 RBL, 2014 WL 1513292, at *2 ("Under Washington law, a limitation period cannot be less than one year from the date the cause of action accrued") (citing R.C.W. 48.18.200 which governs insurance contracts); *Gilman v. Maine Mutual Fire Ins. Co*., 830 A.2d 71, 75 (Vt. 2003) ("Policy provisions establishing limitation periods by contract are valid and enforceable against an insured if the limitation period is not less than 'twelve months from the occurrence of the loss, death, accident or default.'") (citing 8 V.S.A. § 3663).
28. *See, e.g.*, Fla. Stat. Ann. § 95.03 ("Any provision in a contract fixing the period of time within which an action arising out of the contract may be begun at a time less than that provided by the applicable statute of limitations is void."); Ala. Code § 6-2-15 ("Except as may be otherwise provided by the Uniform Commercial Code, any agreement or stipulation, verbal or written, whereby the time for the commencement of any action is limited to a time less than that prescribed by law for the commencement of such action is void."); Idaho Code Ann. § 29-110(1) ("Every stipulation or condition in a contract, by which any party thereto is restricted from enforcing his rights under the contract in Idaho tribunals, or which limits the time within which he may thus enforce his rights, is void as it is against the public policy of Idaho."); Miss. Code. Ann. § 15-1-5 ("The limitations prescribed in this chapter shall not be changed in any way whatsoever by contract."); *Lillibridge v. Nautilus Ins. Co.*, No. CIV. 10-4105-KES, 2013 WL 870439, at *5 (D.S.D. Mar. 7, 2013) ("The South Dakota legislature has stated that the parties may not shorten the length of time a party has to bring a cause of action by contractual agreement and any provision in a contract that does so is void.").

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The New York Court of Appeals Takes the Wrong Fork in the Road on the Common Interest Privilege

By C. Evan Stewart

One of the greatest teen-angst records of the 1960s is undoubtedly Leslie Gore's "It's My Party."[1] At her own birthday party, she discovers that her boyfriend has shown up with Judy "wearing his ring": "It's my party, and I'll cry if I want to,…You would cry too if it happened to you!"[2]

Recently, the New York Court of Appeals tackled the common interest privilege. Because of the Court's excellent past history on matters involving the attorney-client privilege[3] —unlike many other courts,[4]—I had every hope and expectation that the seven judges would do the right thing; indeed, I publicly predicted they would.[5] But I was wrong, and since the Court of Appeals is the court of last resort in New York State my only remedy is to cry at *my* party![6]

I. *Ambac v. Countrywide*

Ambac Assurance Corp. filed suit against Countrywide Home Loans, charging Countrywide with having fraudulently induced it to insure certain residential mortgage backed securities transactions (RMBS); Ambac also alleged that Bank of America should be secondarily liable because of a merger between Bank of America and Countrywide entities. Before those two entities entered into the merger, they executed (*inter alia*) a common interest agreement. One of the benefits of that agreement was that it allowed both entities to share legal advice in order to comply fully with the complex legal and regulatory requirements attendant to the merger.

The "common interest" privilege is not a privilege that stands apart from the attorney-client privilege. Rather, it is an exception to the basic principle that privileged communications with counsel are waived when disclosed to a third party.[7] As recognized by the U.S. Court of Appeals for the Second Circuit, the "common interest" privilege "serves to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel."[8]

Prior to the *Ambac* litigation, New York lawyers attempting to invoke this privilege were faced with an unclear state of affairs: When would the privilege attach? Although the Second Circuit had made it clear it was not required that an "actual litigation [be] in progress for the common interest rule of the attorney-client privilege to apply,"[9] various New York courts had also ruled that the privilege was "limited to where the parties reasonably anticipate, or are currently engaged in litigation."[10]

In the litigation at issue, Ambac sought discovery of hundreds of documents containing the legal advice shared between Countrywide and Bank of America. Ambac contended that such materials were not only directly relevant to Ambac's successor liability claims, but that they also bore on the issue of the Bank of America being on notice of "the prevalence of unreported fraud at Countrywide well after the [merger]." Both the discovery referee and the Supreme Court ruled that Bank of America had to produce these materials, notwithstanding the common interest agreement, on the grounds that there was no pending (or reasonably anticipated) litigation. An unhappy, Bank of America then sought redress in the Appellate Division, First Department.

II. The First Department to the Rescue!

On December 4, 2014, a unanimous First Department decision (per Judge Karla Moskowitz) gave Bank of America the relief it sought—reversing the Supreme Court and holding that the documents at issue were in fact protected from disclosure by the "common interest" privilege.[11]

At the very outset, Judge Moskowitz acknowledged that the First Department had "never squarely decided whether… the communication must affect pending or reasonably anticipated litigation."[12] But drawing upon several decisions by the New York Court of Appeals and the U.S. Supreme Court upholding the attorney-client privilege,[13] the court first (and correctly) noted that the privilege "is not tied to the contemplation of litigation." Not only was that insight fundamental to the resolution of the issue before the First Department, it also highlighted a basic and critical distinction between the attorney-client privilege and the attorney work product doctrine—a critical distinction which courts often misunderstand and which then leads to bad (or worse) results.[14]

Thus, while the work product doctrine has always been keyed to litigation (or the anticipation thereof),[15] the attorney-client privilege has *never* been premised on that notion—except by some courts when addressing the common interest "exception."[16] But "just because" some courts have done so does not mean they were correctly understanding or ruling on the privilege.

Moskowitz did concede that a number of lower courts in New York had required "pending or reasonably anticipated litigation";[17] but in her review of the law elsewhere, she found plenty of encouragement for not embracing that non-binding precedent. The Restatement of the Law Governing Lawyers, for example, expressly states that the common interest privilege applies "in a litigated or *non*-litigated matter."[18] And a number of federal courts have also so ruled, including the Southern and Northern Districts of New York.[19] The First Department also took great stock in the fact that the state of Delaware has codified the non-litigation standard for purposes of the common interest privilege, observing: "we believe that Delaware presents the better approach."[20]

Case law aside, Moskowitz also looked at this issue from a policy standpoint and, again, reached the correct result:

> [I]mposing a litigation requirement in this scenario discourages parties with a shared legal interest, such as the signed merger agreement here, from seeking and sharing that advice, and would inevitably result instead in the outset of regulatory or private litigation because of the parties' lack of sound guidance from counsel. This outcome *would make poor legal as well as poor business policy*.[21]

Conversely, as Moskowitz also correctly observed, the case law supporting the litigation requirement "undermines the policy underlying [the] attorney-client privilege."[22]

Ambac thereafter sought leave from the First Department to appeal to the Court of Appeals; the petition was granted.

III. The Court of Appeals Cold-Showers the Privilege

On June 9, 2016, a divided Court of Appeals reversed the First Department and reinstated the Supreme Court's ruling that the Bank of America materials were not privileged and had to be produced.[23] Writing for the majority, Associate Judge Eugene Pigott started off with a brief review of the Court's prior jurisprudence on the attorney-client privilege, which has highlighted the importance of the privilege in "obtaining or facilitating legal advice in the course of a professional relationship."[24] At the same time, he observed that, because the privilege in litigation blocks relevant information from discovery, it is to be strictly construed; and if not all of the elements of the privilege are present, then the privilege will not be upheld.[25]

Judge Pigott then reviewed the jurisprudential history of the common interest privilege in New York State; his review, not surprisingly, was consistent with that which was done by Judge Moskowitz. He next looked at the state of play outside New York, correctly noting those state and federal courts that are in line with Judge Moskowitz's decision and those that are not. He then gave the majority's reasons for rejecting Judge Moskowitz's ruling.

The principal reason was Judge Pigott's often invoked (five times, by my count) concern for "misuse/abuse" if the common interest privilege were to apply in the non-litigation context. His authority for that proposition was the following: "At least one commentator has also observed that '[t]he greatest push to expand the common interest privilege comes from corporate attorneys representing multiple clients, often in an antitrust context,' and that it is precisely in this context 'that the potential for abuse is greatest.'"[26] The commentator's only authority/evidence for this proposition comes in turn from Professor Charles Alan Wright's treatise on federal procedure.[27] Upon seeing that, I wondered why Professor Wright had so opined; he was, of course, not an antitrust scholar nor an antitrust practitioner—but it is clear from his treatise that he was anti-common interest privilege in *any* context (litigation and otherwise).[28] And when I checked on the professor's authority/evidence for his antitrust "abuse" proposition, what I found was a completely inapposite reference written in 1974 by a Reporter to the Advisory Committee on the Federal Rules of Evidence, as well as a 1954 article by a student at Yale Law School which has nothing to do with the antitrust laws.[29] Putting that "authority" aside, there is, so far as I know, *no* actual evidence of any "abuse" (attempted or otherwise) in the antitrust context; indeed, Professor Wright even cited to a case where, because "both parties were interested in potential antitrust liability…as it would affect the price they were negotiating, their interests were adverse and the [common interest] privilege did not apply."[30] Thus, at bottom, the "abuse/misuse" concern is simply illusory.[31]

What else did Judge Pigott offer up? Well, related to the "abuse/misuse" concern was Judge Pigott's non-linkable concern regarding the "substantial loss of relevant evidence" for litigation and the fact that the Bank of America presented "no evidence" to the Court that "complex commercial transactions have not occurred in New York because of our State's litigation limitation on the common interest doctrine; nor is there evidence that corporate clients will cease complying with the law." Putting to one side how such evidence could in fact have been presented to the Court of Appeals (especially on a discovery dispute),[32] that is surely a straw man argument; the U.S. Supreme Court did not find the need for such "evidence" when it ruled in *Upjohn* that the attorney-client privilege covers all corporate employees so as to ensure that attorneys have unfettered access to the facts in order to give competent legal advice and thus have their corporate clients comply with the law.[33] Beyond that, there would be *no* substantial loss of evidence, since *no* facts would be sheltered from discovery.[34]

Judge Pigott was similarly unmoved by the argument that limiting the common interest privilege to litigation made no sense because the attorney-client privilege has no such limitation.[35] And his final dismissal of the expanded doctrine (rooted in Professor Wright's disapproval of the privilege in *all* contexts)[36] was the fact that Proposed Rule 503(b)(3) of the Federal Rules of Evidence—which was put forward in 1972 and, *inter alia*, would have allowed for a common interest privilege in civil and criminal litigation and for purely transactional contexts—was never adopted by Congress.

His last reason, to this author, really underscores Judge Pigott's entire opinion. He, like the authorities he relied upon, simply does not like the common interest privilege—in *any* context.[37] I guess he could not get enough votes to do away with it, and had to be content with cutting it off from use in the non-litigation arena.

The dissent, by Judge Jenny Rivera, was similar to the analysis of Judge Moskowitz (and thus was correct, in my view). She posited, *inter alia*:

- That *Upjohn* and the Court of Appeals' prior precedents supported extending the privilege to the non-litigation context—to ensure corporate "compliance with legal mandates."[38]
- That the attorney-client privilege has nothing to do with litigation; and thus the common interest privilege should not be so limited.
- That numerous states, federal courts, and commentators (including the Restatement, Judge Weinstein, etc.) support the privilege in the non-litigation context.
- That there is no evidence to support the majority's "abuse"/"misuse" concern; in the state and federal courts that have extended the privilege, it has been done "without disastrous results." And, in any event (and as was demonstrated by the discovery process in the *Ambac* litigation), courts have many tools to address "obstruction of proper discovery."
- And finally, that the crime-fraud exception is the ultimate backstop to prevent entities from trying to wrongly use attorneys to prevent the discovery of on-going or future wrongdoing.

Unfortunately, Judge Rivera only got Judge Michael Garcia's vote, so her correct analysis went for naught.

IV. Where Do We Go From Here?

As an initial matter, it is a bit disheartening that New York's highest court has embraced a course that may well discourage business activity in this state—rather than being more user-friendly for modern commerce. Thus, for example, if faced with a choice of venue, which lawyers would counsel their Delaware-chartered clients to do a deal in New York, as opposed to Delaware (which officially sanctions the common interest privilege)?

But even assuming rational lawyers will now do their deals in Delaware, what can be done if subsequent litigation is brought in New York? First off, any such deal should have a choice of law provision mandating that any disputes arising out of the deal be subject to the laws of Delaware; under a conflicts of law analysis, a New York court may well decide that Delaware law should govern on this point.[39] As an added precaution, lawyers to such a deal may wish to segregate pre-litigation materials to the deal from anticipated litigation materials, explicitly documenting the latter group as being both privileged and protected by the attorney work-product doctrine.[40]

One idea I am not keen on—but has been suggested in light of the Court of Appeals decision—is having parties share the same counsel on sensitive matters in corporate deals.[41] Perhaps some people still believe in the old Brandeis notion of "lawyer for the situation," but that is really *not* appropriate in complex corporate transactions as a matter of professional ethics.[42]

What else can be done is to seek help from the New York State legislature. Judge Pigott invited such a course for those who did not like his opinion, and a number of responsible attorneys in our state have already begun the petitioning/lobbying process.[43] Let us hope that works, especially for the sake of making New York State an enticing place to do corporate deals in the future.

Endnotes

1. (Mercury Records) (Herb Wiener–John Gluck–Wally Gold) (Recorded March 30, 1963; released April 1963; U.S. Billboard Hot 100 #1 May 11, 1963). [The lyrics were actually written by Seymour Gottlieb (who gave them to Herb Wiener); Gottlieb's daughter had suffered this actual indignity at her own Sweet Sixteen party!] A demo of the song had originally been sung by Barbara Jean English; legendary producer Phil Spector loved it, planned to have the Crystals record it, and thought it was sure to be a big hit. Unfortunately for Spector and the Crystals, equally legendary producer Quincy Jones had the unknown Gore record the song on March 30, 1963. By serendipity, both men met at a Carnegie Hall concert on that same day, at which time Spector told Jones of his plans. Jones left the concert and went back to the studio to press enough records to thereafter mail them to influential disc jockeys throughout the country. Gore heard it on the radio for the first time several days later, and it was #1 in the country within a month. Ranking right up there with Gore's tear-jerker is The Shangri-Las's "Leader of the Pack" (Red Bird Records) (George "Shadow" Morton–Jeff Barry–Ellie Greenwich) (U.S. Billboard Hot 100 #1 November 28, 1964). Betty ("I met him at the candy store, he turned around and smiled at me, you get the picture?" Back-up singers: "Yes, we see!") must break up with Jimmy (the leader of the pack) because he comes from "the wrong side of town"—a despondent Jimmy then dies in a motorcycle accident. The Detergents later spoofed this classic with their own hit: "Leader of the Laundromat" (Roulette) (Paul Vance–Lee Pockriss) (U.S. Billboard Hot 100 #19 January 1965). The composers of "Leader of the Pack" sued The Detergents for plagiarism; ultimately, the dispute was settled out of court. All three classics are, not surprisingly, in the author's "45s" collection.
2. On her follow-up hit, Gore wreaked her revenge: "Judy's Turn to Cry" (Mercury Records) (Beverly Ross–Edna Lewis) (recorded May 14, 1963; released June 1963; U.S. Billboard Hot #5 July 6, 1963). Besides a number of other pop-chart hits in the 1960s, Gore also portrayed Pussycat on the TV series "Batman."

3. *See, e.g., Rossi v. Blue Cross and Blue Shield of Greater N.Y.,* 73 N.Y.2d 588 (1989); *See also Spectrum Sys. Intl. Corp. v. Chemical Bank*, 78 N.Y.2d 371 (1991).

4. *See, e.g., Kellogg Brown & Root*, 756 F.3d 754 (D.C. Cir. 2014); *Eastman Kodak Co. v. Kyocera Corp.,* 2011 WL 1432038 (W.D.N.Y. April 14, 2014); *U.S. v. Textron*, 557 F.3d 21 (1st Cir. 2009); *Georgia Pacific v. GAF. Roofing*, 1996 U.S. Dist. LEXIS 671 (S.D.N.Y. 1996); *In re von Bulow*, 828 F.2d 94 (2d Cir. 1987); *Diversified Industries v. Meredith*, 572 F.2d 596 (8th Cir. 1997); *Melworm v. Encompass Indemnity*, 37 Misc. 3d 389, 951 N.Y.S. 2d 829 (Nassau City Sup. Ct. July 16, 2012). See C.E. Stewart, *The D.C. Circuit: Wrong and Wronger!,* NY Business Law Journal (Winter 2015).

5. *See, e.g.,* C.E. Stewart, *Judge Gets Common Interest Privilege Spot On*, New York Law Journal (April 7, 2015).

6. And, of course, write this article, demonstrating the error of the Court's ways.

7. *See* C.E. Stewart, *The Attorney-Client Privilege: The Best of Times, the Worst of Times*, Professional Lawyer 63 (2000).

8. *U.S. v. Schwimmer*, 899 F.2d 237, 243 (2d Cir. 1989). *See also People v. Osorio*, 75 N.Y. 2d 80 (1989); *Chahoon v. Commonwealth*, 62 Va. (21 Gratt.) 822 (1871).

9. *U.S. v. Schwimmer*, 899 F.2d at 244. *Accord Schaeffler v. U.S.,* 806 F.3d 34, 40 (2d Cir. 2015).

10. *See, e.g., Nat'l Union Fire Ins. Co. of Pittsburgh v. Trans-Canada Energy*, 2013 N.Y. Misc. LEXIS 3735, *10 (Sup. Ct. N.Y. Co. 2013); *Polycast Tech. Corp. v. Uniroyal*, 125 F.R.D. 47, 50 (S.D.N.Y. 1989); *Stenovich v. Wachtell, Lipton, Rosen & Katz*, 192 Misc. 2d 99, 108 (N.Y. Sup. Ct. 2003).

11. 124 A.D.3d 129, 998 N.Y.S. 2d 329 (1st Dept. Dec. 4, 2014).

12. *See id*. at 130.

13. *E.g., Spectrum, supra* note 3; *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

14. *See* C.E. Stewart, *supra* note 7; *see also supra* note 4.

15. *See Hickman v. Taylor*, 329 U.S. 495 (1947); *U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1988).

16. Unfortunately, some judges have on occasion (improperly) superimposed litigation as a condition for the privilege to apply. *See, e.g., Georgia Pacific, supra* note 4.

17. *See supra* note 10.

18. *See* Restatement (Third) of the Law Governing Lawyers §76 (2006) (emphasis added).

19. *See, e.g., Fox News Network v. U.S. Dept. of the Treasury*, 739 F. Supp. 2d 516, 563 (S.D.N.Y. 2010); *LG Elecs. U.S.A., Inc. v. Whirlpool Corp.*, 661 F. Supp. 2d 958, 965 (N.D. Ill. 2009); *In re Teleglobe Communications Corp*., 493 F.3d 345, 364 (3d Cir. 2007); *United States v. BDO Seidman*, 492 F.3d 806, 815-16 (7th Cir. 2007); *Lugosch v. Congel*, 219 F.R.D. 220, 238 (N.D.N.Y. 2003); *United States v. United Technologies Corp.,* 979 F. Supp. 108, 112 (D. Conn. 1997); *In re Regents of the Univ. of Cal.,* 101 F.3d 1386, 1389 (Fed. Cir. 1996). *Accord see supra* note 9. *See also OXY Res. California v. Superior Court*, 9 Cal. Rptr. 3d 621, 628-27 (2004).

20. 998 N.Y.S. 3d at 336. *See* Del. Uniform R. of Evid. §502(b). *See also 3 Com Corp. v. Diamond II Holding,* 2010 WL 3426, *2 (Del. Ch. March 20, 1986).

21. 998 N.Y.S. 2d at 335 (emphasis added). Earlier, the court (citing *BDO Seidman, supra* note 19) had written that the whole purpose of the privilege is to "serve[s] the public interest by advancing compliance with the law, facilitating the administration of justice and averting litigation." *Accord Upjohn*, 449 U.S. at 389.

22. 998 N.Y.S. 2d at 334-35.

23. 2016 WL 3188989 (N.Y. June 9, 2016). Associate Judge Eugene Pigott wrote the majority opinion; it was joined in by Associate Judges Sheila Abolus-Salaam, Leslie Stein, and Eugene Fahey. The dissenting opinion was authored by Associate Judge Jenny Rivera; it was joined in by Associate Judge Michael Garcia. Chief Judge Janet DiFiore did not participate in the decision.

24. *See supra* notes 3 and 12.

25. He is correct insofar as, for the privilege to exist, there must be "5 Cs:" (i) a client; (2) a communication; (3) confidentiality; (4) counsel (an attorney); and (5) counsel (the giving of legal advice by an attorney). Four out of five Cs is not sufficient; there must be all five for the privilege to exist. *See* C.E. Stewart, *Attorney-Client Privilege: Misunderestimated or Misunderstood?* New York Law Journal (October 20, 2014). He is *not* correct insofar as the privilege does *not* block from discovery relevant information (i.e., facts); rather, it blocks from discovery confidential communications between clients and their lawyers. *Id.*

26. Edna S. Epstein, The Attorney-Client Privilege and the Work-Product Doctrine 277 (5th ed. 2007).

27. *See* 24 Charles Alan Wright & Kenneth W. Graham, Federal Practice and Procedure §5493 (1986 Supp. 2003). In his treatise, Professor Wright candidly conceded that he differs from Judge Weinstein on whether the privilege should extend to non-litigation contexts. *See* 2 Weinstein & Berger, Weinstein's Evidence 503-60 (1980); Weinstein Evidence Manual ¶18.03(3)(b) (2015).

28. Although I do not agree with it, there is a respectable academic argument that there should be *no* common interest privilege in *any* context. *See* G. Giesel, "End the Experiment: The Attorney-Client Privilege Should Not Protect Communications in the Allied Lawyer Setting," 95 Marquette L. Rev. 475 (2011). Professor Giesel, for example, argues that *Chahoon* (*see supra* note 8) "was in error." *Id*. at 482. Professor Giesel's article was also relied upon by Judge Pigott.

29. *See* E. Cleary, "Article V: Privileges," 33 Fed. B.J. 62, 66 (1974) (Professor Cleary was *not* referencing pre-litigation communications; rather, he was referencing the common post-litigation practice of defense attorneys sharing information to defend against antitrust conspiracy claims—a perfectly *appropriate* activity, then and now—*see infra* note 30); Note, "Waiver of Attorney-Client Privilege on Inter-Attorney Exchange of Information," 63 Yale L.J. 1030, 1034 (1954) (at the time the enterprising law student wrote his or her note, there were only a handful of common interest privilege cases, none of which implicated the antitrust laws).

30. *See SCM Corp. v. Xerox Corp.,* 70 F.R.D. 508, 513 (D. Conn. 1976). *See also In re Santa Fe Intern. Corp.,* 272 F.3d 705, 710 (5th Circuit 2001) (also cited by Professor Wright—for the obvious proposition that the common interest privilege cannot be used as a shield to avoid liability for conspiracy to violate the antitrust laws).

31. Of course, once antitrust litigation has *commenced* the common interest privilege is regularly employed so that counsel for the target entities can share information. The flip side can *never* pass muster: i.e., using the common interest privilege as a means to further/conceal an antitrust conspiracy -- such a ploy would clearly run afoul of the crime-fraud exception to the privilege. *See, e.g., In re: Grand Jury Subpoena Duces Tecum (Rich),* 731 F. 2d 1032, 1041 (2d Cir. 1984). *See also supra* note 29.

32. The only way any such "evidence" could have been coopered up, I suppose, would have been via the Chamber of Commerce's *amicus curiae* brief (although any factual proffer would not constitute "evidence"). The Chamber's brief apparently focused on the fact that there was no "actual abuse" in the case at hand or in the jurisdictions that do not have a litigation requirement. Judge Pigott was obviously not influenced by that "evidence," being more convinced by the unproven and unquantifiable "potential for abuse."

33. *See supra* note 11. And, as set forth above, it is this same public policy that Judge Moskowitz cited in her decision. *See supra* note 20 and accompanying text.

34. *See supra* note 24.

35. To support this view he cited a footnote from *In re Megan-Racine Assocs., Inc.*, 189 BR 562, 573 n.8 (Bank N.D.N.Y. 1995).

36. As well as Professor Giesel's general disapproval. *See supra* note 28.

37. In fact, Judge Pigott quoted with approval Professor Wright's dismissive comment that the common interest privilege has been "spreading like crabgrass"; it would appear that the Judge hopes by liberally applying weed-killer he will keep the "crabgrass" to a minimum in New York State.

38. *See supra* notes 11, 20 & 32.

39. *See Hyatt v. State Franchise Tax Board*, 105 A.D. 3d 186, 962 N.Y.S. 2d 282 (2d Dept. 2013); D.A. Cohen, *New York Court of Appeals Clarifies the Common Interest Doctrine*, New York Law Journal (June 29, 2016).

40. Although Judge Pigott expressly declined to define for common interest privilege purposes what constitutes "anticipation of litigation," the Second Circuit's definition for purposes of the work-product doctrine should be a safe guide for lawyers in this context. *See U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1998); *see also* C.E. Stewart, *Policing the Corporate Beat: One Small Step for Man…*, New York Law Journal (May 7, 1998). *See generally* M. Greene, *More Private M&A Deals Are Addressing Ownership of Attorney-Client Privilege*, ABA/BNA Lawyers' Manual on Professional Conduct 520 (August 24, 2016).

41. *See* M.B. Espana & M.J. Sullivan, *Protecting Communications and Work Product After 'Ambac II,'* New York Journal (August 21, 2016).

42. *See* G.C. Hazzard, *Lawyer for the Situation*, 39 Valpariso U.L. Rev. 377 (2004).

43. *See* S.D. Aaron, J. Berick & C.D. Cheslak, *Preserving Attorney-Client Privilege in M&A Transactions*, New York Law Journal (August 8, 2016).

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Attorney-Client Privilege Update

By Michael J. Hutter

In the 2015-2016 Court Term, the New York State Court of Appeals and the Appellate Division, First Department, decided three significant cases affecting the scope and application of New York's attorney-client privilege as codified in CPLR 4503 (a). Transactional attorneys must be aware of them as they directly impact their practice. This article will address these decisions.

I. No Pending or Anticipated Litigation? No Common Interest Doctrine to Protect Confidential Communications When Disclosed

Ambac Assurance Corp. v. Countrywide Home Loans, Inc., 27 N.Y.3d 616 (2016)

In Issue

The common interest doctrine, when applicable, provides that when an attorney-client privileged communication is disclosed to a third party it remains privileged if the third party shares a common legal interest with the client and the communication was made in furtherance of that common legal interest. In essence, it creates an exception to the general rule that disclosure of a confidential communication to a third party results in a loss of the communication's privileged status. At issue in *Ambac* was whether the disclosed communication must relate to pending or anticipated litigation for the doctrine/exception in fact to apply.

Facts

Ambac arose from an action commenced by Ambac Assurance against Countrywide Home Loans, wherein it was alleged that Countrywide fraudulently induced Ambac to insure payments on certain residential mortgage-backed securities. Ambac also alleged claims against Bank of America Corp. ("BAC"), which acquired Countrywide in 2008.

Before signing the merger agreement, BAC and Countrywide entered into a common interest agreement. This agreement governed all privileged information that was shared pre-closing "to advance their common interests in resolving many legal issues necessary for successful completion of the merger" and was made in an effort to prevent the privilege from being lost by the contemplated sharing. The merger agreement itself required the parties to work together on several pre-closing matters and prepare and file a joint proxy and registration statement.

In its action, Ambac sought disclosure of several hundred documents involving communications between BAC and Countrywide and their attorneys prior to the close of the merger. It contended the communications were relevant to its claims and that the attorney-client privilege was waived when the communications were shared before the merger's completion. In this connection, Ambac argued that the pre-merger communications lost their confidential status because no litigation was pending at the time.

BAC refused to produce the documents, claiming that they were protected against disclosure by the common interest privilege/exception as contemplated by their agreement and Ambac moved to compel their production. The Special Referee (retired Justice John A.K. Bradley) ordered production of the documents. *Ambac*, 2013 N.Y. Slip Op. 32568(U). Justice Eileen Bransten denied BAC's motion to vacate the order, reasoning that "New York law does not allow a privilege claim under the common interest doctrine unless there is pending or reasonably anticipated litigation," and none was present here. *Ambac*, 2013 N.Y. Slip Op. 51673(U) at *2 (Sup. Ct. N.Y. Co.).

The First Department unanimously reversed. In an opinion written by Justice Karla Moskowitz, the Court held for the first time in New York that "pending or reasonably anticipated litigation is not a necessary element of the common interest privilege." *Ambac*, 124 A.D.3d 129 (1st Dept. 2014). In so ruling, the Court rejected prior precedent in New York imposing that requirement for the common interest doctrine as it found that requirement inconsistent with the purposes of the attorney-client privilege and with the weight of authority in the federal courts and in Delaware state courts. The Court then remanded the matter for a determination as to whether the documents were privileged under its reformulation of the common interest doctrine.

Court of Appeals Decision

The Court of Appeals reversed, in an opinion authored by Judge Eugene Pigott, with Judges Jenny Rivera and Michael Garcia dissenting, and Chief Judge Janet DiFiore recusing herself. The Court unambiguously held: "[A]s the courts in New York have held for over two decades, . . . any communication [of privileged information to a third-party] must also relate to litigation, either pending or anticipated for the [common interest] exception to apply." *Ambac,* 27 N.Y.3d at 620. In the majority's view, it is only in litigation that "the benefit and the necessity of shared communications are at their highest and the potential for misuse minimal," *Id*. at 628, and expanding the common interest doctrine to non-litigation situations would be at the cost of the loss of relevant evidence. Such loss was not justified as the fact that the parties "shared interest in the transaction's completion is already an adequate incentive for exchanging information necessary to achieve that end." *Id*. at 629.

Comment

The Court's *Ambac* decision has its critics. See, Aaron et al., "Preserving Attorney-Client Privilege in M&A Transactions," NYLJ. August 8, 2016, p. 3, col. 3; Minkoff, "N.Y. Court of Appeals Narrowly Interprets Common Interest Exception to Attorney-Client Privilege," New York Legal Ethics Reporter, June/July 2016 issue. However, as noted by a leading New York evidence commentator: "The Court's decision embraces the reality that legal compliance in the commercial context does not depend on the sharing of behind-the-scenes attorney-client communications to the same extent as in the mounting of a joint litigation strategy." Alexander, 2016 Practice Commentaries to CPLR 4502, McKinneys Con Laws of NY.

Takeaways

The Court's decision leaves no exception to the common interest doctrine when litigation is not at all involved in the disclosure of confidential communications to a third party. In that connection, the dissenters, who did not seem to embrace a no-litigation rule for all commercial transactions, were clearly in favor of a no-litigation requirement in the context of mergers and acquisitions, or at least the merger involved in the case before the Court.

As a result, attorneys and their clients, when exchanging information in a pre-closing situation with the other party to the transaction and its attorneys, must now exercise caution in that exchange lest privileged information be shared, causing the likely disclosure of that information in subsequent litigation involving third parties, including the government. All information to be exchanged should, in short, be carefully screened, and when confidential communications are identified, a decision should then be made as to whether the exchange is truly necessary to the consummation of the transaction.

Notably, the Court expressly declined to decide "what it means to share common legal interests in pending or anticipated litigation." *Ambac,* 27 N.Y.3d at 630, n.4. All the Court stated on this issue is that the litigation "must be ongoing or reasonably anticipated, and the exchanged communication must relate to it." *Id*. As to this litigation requirement, it must be kept in mind that the Court rejected BAC's argument that since merger and acquisition deals, especially those involving financial institutions, invariably spawn litigation, the litigation requirement should be found to be present. *Id*. at 628. Nor does it seem, in light of that rejection, that a mere contractual provision expressing the parties' belief that litigation is likely in the future would satisfy the requirement. How then is the requirement to be established? Since the language used by the Court is similar to the language of CPLR 3101(d)(2), which addresses the disclosure of "materials" which are "prepared in anticipation of litigation or for trial," case law discussion of that provision should be relevant for purposes of determining whether the litigation requirement has been established. In any event, when there is a belief of anticipated litigation, attorneys should through contemporaneous documentation establish a record for such belief, stating the reasons for that belief.

Ambac recognized that many courts have rejected the litigation requirement in transactional matters. As a result, disclosure of confidential communications will defeat the privilege if New York law is applicable but not, for example, if Delaware law applies. Thus, choice of law issues may arise in litigation commenced in a New York court where there is some basis to argue that another jurisdiction's privilege law should be applied. New York courts apply an interest analysis, namely, "the law of the jurisdiction having the greatest interest in the litigation will be applied and. . .the facts or contacts which obtain significance in defining State interests are those which relate to the purpose of the particular law in conflict." *Hyatt v. State Franchise Tax Bd.,* 105 A.D.3d 186, 204 (2d Dept. 2013). Determination of the proper forum will thus require much thought and analysis.

Lastly, *Ambac* does not at all undermine a basic tenet of the privilege, namely, that invocation of the privilege does not depend upon the existence of pending or prospective litigation, as the privilege is not tied to the contemplation of litigation. *See Root v. Wright,* 84 N.Y. 72, 76 (1881); *Bacon v Frisbie,* 80 N.Y. 394, 400 (1880). The reason is that the issue in *Ambac* was not the privilege itself but rather how far access to otherwise privileged communications should extend.

II. Privileged Today? Possibly Not Tomorrow if Shareholder Litigation Is Involved

NAMA Holdings, LLC v. Greenberg Traurig, LLP, 133 A.D.3d 46 (1st Dept. 2015)

In Issue

The fiduciary exception to the attorney-client privilege provides an exception to that privilege with respect to confidential communications between a trust's trustee and the trust's attorney in litigation involving breach of fiduciary duty or similar wrongdoing in the management of the trust. Under this exception, where a trustee, acting on behalf of the trust beneficiaries, has expended trust funds to obtain legal advice in executing his or her fiduciary duties, communications with the retained attorney are not privileged. The rationale is that in such circumstances the trustee is acting ultimately on behalf of the trust's beneficiaries, who are the real clients of the attorney, and thus those communications cannot be withheld from the beneficiaries. In short, the attorney-client privilege properly belongs to the beneficiaries rather than the trustee. At issue in *NAMA Holdings* was whether the fiduciary exception extends to the corporate environment.

Facts

NAMA Holding LLC was the majority investor in Alliance Network LLC, a group of companies created to develop commercial properties in Las Vegas that were slated to become the world's largest showroom facility. Beginning in 2003, disputes arose between NAMA, Alliance's managers, and Alliance's members regarding NAMA's refusal to provide funding for the project in response to allegedly improper capital calls, and regarding NAMA's complaint that information was not being provided in accordance with Alliance's operating agreement.

This dispute culminated in an action commenced by NAMA against Alliance's management and its outside counsel in 2008, wherein direct and derivative claims were alleged. With respect to the management officials, NAMA alleged that their activities violated their fiduciary duty to Alliance, constituted tortious interference with Alliance's prospective economic advantage, and resulted in a conversion of its future business opportunities. As to outside counsel, NAMA alleged that counsel had breached their fiduciary duty to Alliance (and to NAMA) by advising management regarding management's alleged attempt to misappropriate Alliance's assets and business opportunities.

In response to NAMA's discovery requests, Alliance's outside counsel produced a privilege log containing 3,000 entries. It was asserted that the entries related to documents which were protected by the attorney-client privilege between counsel and Alliance. NAMA then moved to compel production of all documents identified in the privilege log. It argued that the documents were not protected by the privilege as the fiduciary exception was applicable. Defendants countered by arguing that NAMA's interests were adverse to Alliance's interests, rendering the fiduciary exception inapplicable.

Supreme Court, Judge Eileen Bransten, held that the fiduciary exception applied as a general proposition to the otherwise privileged communications. However, the exception would not apply to communications "during the period of time that the parties were not in an adversarial posture." *NAMA*, 2013 Slip Op. 3398(U). Upon remand, the special referee for discovery concluded after conducting a hearing that NAMA and Alliance were never in an adversarial relationship. Upon this finding, Supreme Court then ordered production of all of the documents on the privilege log. *Id*. at 50–52.

First Department Decision

The First Department, in an opinion authored by Justice Rolando Acosta, reversed and remanded the matter for further proceedings in accordance with its decision. In so ruling, the court initially, as did Judge Bransten, confirmed the existence of the fiduciary exception in New York's common law and then extended its potential application in shareholder litigation. As to the latter, the court followed the lead of the Fifth Circuit Court of Appeals in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). *Garner* held that a court could, in appropriate circumstances, apply the fiduciary exception when shareholders seek to discover communications between a corporation's management and its attorneys. The *NAMA* Court agreed with *Garner* that "where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance." *NAMA*, 133 A.D.3d at 53.

As to when the exception could be invoked, the *NAMA* Court again followed *Garner,* which held that access to otherwise privileged communications under the exception would only be allowed upon a showing of "good cause." *Garner*, 430 F.2d at 1103–1104. The *NAMA* Court stated, in support of the "good cause" test, that it struck "the appropriate balance between respect for the privilege and the need for disclosure." *NAMA*, 133 A.D.3d at 56. In so concluding, the *NAMA* Court specifically noted that "[a] blanket application of the exception whenever a fiduciary relationship is present would too easily abrogate the privilege, thereby discouraging candid discussion between corporate attorneys and management." *Id.* at 56, n. 7.

"The NAMA Court stated, in support of the 'good cause' test, that it struck 'the appropriate balance between respect for the privilege and the need for disclosure.'"

In adopting *Garne*r's good cause test, the *NAMA* Court also approved the factors that *Garner* stated should be considered in determining whether a party has established the requisite good cause. *Id*. at 54, n. 6. These factors include (1) "the number of shareholders and the percentage of stock they represent," (2) "the bona fides of the shareholders," (3) "the nature of the shareholders' claim and whether it is obviously colorable," (4) "the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources," (5) "whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality," (6) "whether the communication related to past or to prospective actions," (7) "whether the communication is of advice concerning the litigation itself," (8) "the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing," and (9) "the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons." These factors were described as "non-exhaustive." *Id*. at 55. The Court also commented generally as to how certain of these factors may affect the "good cause" determination.

Supreme Court had based its decision solely on factor #7, the absence of litigation at the time the communications were made. The *NAMA* Court held that this was error as a court's analysis required a consideration of all the factors, with no one factor being dispositive. The content of the communication, together with its timing, and whether there was adversity or adversity at the time of disclosure, were factors to be considered. Overall, a comprehensive analysis of all relevant factors must be made. *Id*.

The Court then found that remand was appropriate, where its enunciated test could be applied to the communications in issue. In this connection, the Court noted that *in camera* review would be required of at least some of the documents on the privilege log and recognized that it was giving Supreme Court a "difficult task." *Id*. at 60.

Comment

Garner has also been followed in most federal courts and several state courts. However, some federal and state courts have refused to follow *Garner. See* Greenwald, Testimonial Privileges (3d ed) 1:44. Recently, the Delaware Supreme Court adopted *Garner in Wal-Mart Stores v. Indiana Industrial Workers*, 95 A3d 1264 (Del. 2014). In doing so, the Court noted that the fiduciary exception was "narrow, exacting and intended to be very difficult to satisfy." *Id*. at 1289. A recent criticism of *Garner* is Cooper, *An Uncertain Privilege: Reexamining Garner v. Wolfinbarger and Its Effect on Attorney-Client Privilege*, 35 Cardozo L. Rev. 1217 at 1234.

Takeaways

Initially, it is clear, as one commentator has observed, that "in disputes among the owners of business entities in New York, when shareholders or members challenging management decisions demonstrate good cause, they are entitled to receive communications between the company and its counsel which might otherwise be privileged." Miller, *Test for Applying Fiduciary Exception to Privilege*, NYLJ, Nov. 6, 2015, p.3, col. 3. As a result, attorneys who represent "a party that owes fiduciary duties need to be more sensitive to the possibility that their communications will not be deemed privileged in subsequent litigation." Schneider, et al., *Privileged Today, But Maybe Not Tomorrow*, Stroock Special Bulletin, Nov. 17, 2015 (available at www.stroock.com/publications/privileged-today-but-maybe-not-tomorrow).

As to future issues involving the exception, *NAMA* will have to be taken into account. Such issues include: whether the good cause test applies in all cases where the exception is applicable, including cases involving trusts; whether the exception applies in non-derivative shareholder actions; and whether the exception extends to statutory fiduciary relationships. State and federal courts are struggling with these issues.

III. Intra-Firm Privilege? When and How Far Does It Extend?

Stock v. Schnader Harrison Segal & Lewis, 142 A.D.3d 210 (1st Dept. 2016)

In Issue

When attorneys retain outside counsel to represent them in a matter involving a current or former client regarding an issue that arose during the client's representation, their confidential communications with the retained attorney will generally be protected by the attorney-client privilege. When attorneys consult with their firm's general counsel or in-house counsel regarding their ethical obligations in representing a firm client whom the attorneys are representing, are their otherwise confidential communications also protected by the attorney-client privilege when the client seeks disclosure of them in an action brought against the attorneys and the firm? *Stock* is a case of first impression in New York as to this issue.

Facts

The Schnader firm represented Keith Stock in connection with the negotiation of a separation agreement with his former employer, MasterCard. The firm, among other things, negotiated for and obtained a delay in Stock's termination date, which allowed additional options to vest. However, neither Stock nor the firm recognized that Stock's termination caused a drastic shortening of the periods during which he could exercise the options (the exercise periods were reduced from 10 years to between 90 and 120 days). Consequently, the firm did not attempt to negotiate, in connection with the termination, an extension of that drastically shortened period for Stock to exercise his options.

Stock was subsequently informed by the administrator of MasterCard's stock option plan that all of his stock options had expired as he had not exercised his options within the specified period. After consulting with the Schnader firm, the firm filed on behalf of Stock a lawsuit against MasterCard and an arbitration action against the option plan administrator. The firm lawyers who represented Stock in these matters had not been involved in the firm's representation of Stock with respect to the separation agreement, and the firm partner who had represented Stock with respect to the separation agreement did not represent him in the arbitration or litigation.

Shortly before the hearing date for the arbitration, the attorney for the option plan administrator announced that it intended to call the Schnader firm partner who had represented Stock in negotiating the separation agreement as a fact witness. As a result of the demand for testimony from the Schnader firm partner, that partner and the Schnader firm lawyers representing Stock in the arbitration and litigation sought legal advice from the Schnader firm's in-house general counsel as to their and the firm's ethical obligations under the advocate-witness rule. At the arbitration a Schnader firm partner testified. The arbitration panel rejected all of Stock's claims against the administrator, and the federal court dismissed most of Stock's claims against his former employer. The action was later settled.

Subsequently, Stock commenced a malpractice litigation against the Schnader firm and the partner who had represented him as to the separation agreement. Stock sought in discovery, among other documents, some two dozen emails between the Schnader firm's in-house general counsel and the lawyers who had consulted with him on the ethical issue, which emails the firm contended were protected by the attorney-client privilege. Supreme Court, Judge Melvin L. Schweitzer, granted Stock's motion to compel production of the emails, holding that the communications were not privileged as to Stock upon the apparent basis that disclosure was required under the fiduciary exception to the privilege. In this connection, Stock was viewed as the client. *See, Stock*, 2014 N.Y. Slip Op. 33171 (U) (Sup. Ct. N.Y. Co.).

First Department Decision

The First Department, in a unanimous opinion authored by Justice David Friedman, reversed and held that the communications should not be disclosed to Stock as they were protected by the privilege. In its view, when attorneys seek the advice of their firm's in-house counsel concerning possible conflicts between their ethical obligations and potential liabilities arising from the representation of a current firm client, the in-house counsel's "real clients" are the lawyers and the firm itself and not the firm client from whose representation the issue arose. Thus, communications seeking or rendering such advice may be withheld from the firm client as privileged. The Court further noted that the attorneys had their own reasons, apart from any duty owed to Stock, for seeking the legal guidance. Because the purpose of the consultation with the firm's in-house/general counsel was to ensure that the attorneys and the firm understood and adhered to their ethical obligations as legal professionals, they, not plaintiff, were the "real clients" in that consultation. *Stock*, 142 A.D.3d at 223–226.

Of note, the Court in so ruling determined that the fiduciary exception, which was at issue in *NAMA Holdings*, was inapplicable here, as the attorneys were seeking advice to protect their own individual interests rather than to guide any "fiduciary" in the performance of his or her duties to the "beneficiary", i.e., the client, Stock. *Id.* at 224–225. The Court also rejected efforts to create another, and different, exception to the privilege to be called the "current client exception."

Such an exception provides that a law firm cannot invoke the attorney-client privilege to withhold from a client evidence of any internal communications within the firm relating to the client's representation, including consultations with the firm's in-house counsel, that occurred while the representation was ongoing. As pointed out by the Court, unlike the fiduciary exception, the current client exception apparently bars invocation of the attorney-client privilege regardless of the identity of the "real client" to whom the legal advice in question was rendered. *Id*. at 227–231.

Comment

The *Stock* Court created, in essence, an intra-law firm privilege which the firm can invoke to resist a former client's demand for disclosure of those communications which are otherwise privileged. In so holding, the Court aligned itself with the majority of the courts in other jurisdictions that have addressed the issue in recent years. *Id*. at 229. Courts which have ruled otherwise have based their decisions on the applicability of the fiduciary exception and/or the current client exception. The *Stock* Court's cogent rejection of those exceptions will very likely lead other courts which have not yet addressed the issue to follow *Stock*, 142 A.D.3d at 229.

Takeaways

While not stated as pre-conditions for the applicability of the privilege, it is important to note that *Stock* emphasized two facts in finding the privilege applicable in the circumstances before it. They are that the in-house counsel did not do any work for the client, and the firm did not charge the client for any time that in-house counsel spent in handling the queries. These two facts appeared to influence the *Stock* court when it held, for purposes of the privilege, that the firm and its attorneys were the in-house counsel's clients. This emphasis strongly suggests that had in-house counsel previously performed any work on the particular client matter at issue or a substantially related matter, or had in-house counsel billed the client for his time, the Court might not have found the privilege applicable. In this connection, the Massachusetts Supreme Judicial Court, in *RFF Family Partnership, LP v. Burns & Levenson, LLP,* 991 N.E.2d 1066 (2013), which *Stock* cited in support of its ruling, held that the presence of these two facts will defeat the application of the privilege.

> *"Thus, where the law firm relies upon a designated in-house counsel, care should be taken to ensure that such attorney has not represented the client on the matter involved or a substantially related matter beforehand."*

Thus, where the law firm relies upon a designated in-house counsel, care should be taken to ensure that such attorney has not represented the client on the matter involved or a substantially related matter beforehand. Where such prior representation is present, consideration should be given to retaining outside counsel for advice. While another firm attorney could be called upon instead, assuming that is permitted and specifically provided for by the firm's practice, caution still suggests that the use of outside counsel is the better way to go. Likewise, the client should not be billed for the time spent by the in-house counsel and the firm's attorneys in dealing with the client matter. Any costs should be borne by the law firm.

While *Stock* arose in a situation where the firm employed a general counsel who did not represent any of the firm's clients but only represented the firm in its affairs, *Stock* does not seem to be limited only to such situations. In this regard, there seems to be no reason why a firm that may not be able as a practical matter to establish a full-time general counsel position cannot formally designate an attorney in the firm to handle on an ongoing basis legal and ethical queries as they arise, in addition to his or her usual client work. In such circumstances, the privilege should be recognized, provided in a given case that the attorney has not been representing the client involved or billing time to the client for the consultation. It should be stressed that simply because a partner is the "managing partner," that designation may not be sufficient to invoke *Stock* in the absence of some formal designation to handle legal and ethical matters. As two commentators have emphasized, a firm might be well advised to "institutionalize" the position and avoid ad hoc designations when the need arises. (*See* Evans and Klevens, "Exercising Attorney-Client Privilege Over In-House Counsel Communications," Daily Report, July 18, 2016 [ALM Media]). Of note, a recent New Hampshire decision has taken this position. (*See Moore v. Grahm,* available at www.courts.state.nh.us/superior/orders/bcdd/Moore-v-Grau.pdf).

As with all attorney-client communications, the communications between the in-house counsel and the firm's attorneys must be made in confidence. The fact that the communications are all internal and made between firm attorneys does not mean that informality is acceptable. Furthermore, the communications must be kept confidential. Disclosure of the communications to persons other than the involved attorneys or persons consulted for assistance will result in a waiver of the privilege and thus should be avoided.

Lastly, it is worthwhile to keep in mind that in the event the client and the firm become adversaries in a malpractice action, recognition of the intra-firm privilege does not guarantee that communications with the in-house counsel will never have to be disclosed. As *Stock* itself expressly states, the privilege may be lost in that litigation if an "advice of counsel" defense is raised by the firm and support for that defense stems from those communications for which the privilege is claimed. *Stock*, 142 A.D.3d at 241.

Michael J. Hutter is a Professor of Law at Albany Law School. This article draws upon previous articles that were published in the *New York Law Journal. See* Hutter, *Ambac's New Exception to Waiver of Confidentiality*, NYLJ, Feb. 2, 2015, p.3, col. 3; Hutter, *Fiduciary Exception to Privilege in Shareholder Litigation*, NYLJ, Feb. 3, 2016, p.3, col. 3; Hutter, *Attorney-Client Privilege and Related Common Interest Exception*, NYLJ, Aug. 2, 2016, p. 3, col. 3; Hutter, *Stock and Application of the Intra-Firm Privilege*, NYLJ, Oct. 5, 2016, p. 3, col. 3.

Inside the Courts

An Update From Skadden Securities Litigators

Class Actions—Settlements

Seventh Circuit Reverses, Remands Approval of Class Action Settlement

In re Walgreen Co. Stockholder Litig. No. 15-3799 (7th Cir. Aug. 10, 2016)

The 7th Circuit reversed and remanded the approval of a class action settlement arising out of a shareholder lawsuit brought against Walgreen Co. after it announced its intent to acquire a foreign company and reorganize. Soon after Walgreen filed its proxy statement for the transaction, shareholders filed suit seeking additional disclosures. Eighteen days later, the parties entered a settlement agreement that (i) provided six supplemental disclosures to the shareholders, (ii) released Walgreen from all disclosure-related liability, and (iii) authorized class counsel to seek attorneys' fees without objection from Walgreen. Despite the district court's skepticism, it ultimately found that the supplemental disclosures "may have" mattered to a reasonable investor and thus approved the settlement.

The 7th Circuit held that the proper inquiry is whether the supplemental disclosures are likely to matter to a reasonable investor, not whether they may matter. Adopting the standard cited by the Delaware Court of Chancery in *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 894 (Del. Ch. 2016), the court explained that such disclosures must both address and correct "a plainly material misrepresentation or omission." Examining the six supplemental disclosures provided to Walgreen shareholders through the settlement, the court determined that the information in them was either redundant and already contained in the proxy filing, derived from the proxy filing, or had no impact on the formation or operation of the new company. Thus, the disclosures neither addressed nor corrected a plainly material misrepresentation or omission. The court went on to criticize the litigation altogether, stating, "[t]he only concrete interest suggested by this litigation is an interest in attorneys' fees, which of course accrue solely to class counsel and not to any class members." Accordingly, the court reversed and remanded the case and directed the district court to consider appointing new class counsel or dismissing the suit.

Demand Futility

Eighth Circuit Affirms Dismissal of Shareholders' Derivative Suit for Failing to Establish Demand Futility

Cottrell ex rel. Wal-Mart Stores, Inc. v. Duke, No. 15-1869 (8th Cir. July 22, 2016)

The 8th Circuit affirmed the dismissal of a derivative action brought by shareholders against certain past and present directors and officers of a consumer goods retailer. The shareholders brought claims for breach of fiduciary duty and violations of Sections 14(a) and 29(b) of the Securities Exchange Act, accusing the directors and officers of breaking federal and state law by acquiescing to and then covering up alleged pervasive bribery committed in the retailer's Mexican operations. The plaintiffs claimed that any demand to the board would have been futile because the board knew of the alleged bribery and was incapable of fairly determining whether to pursue the claims. The district court dismissed the case on the basis that the shareholders' explanation was not specific or detailed enough to satisfy the requirements of Federal Rule of Civil Procedure 23.1 and Delaware's heightened pleading threshold for derivative lawsuits.

On appeal, the plaintiffs offered three accounts for how the reports of alleged bribery reached the board: (i) the audit committee chair received preliminary investigation findings and alerted the rest of the board, (ii) senior officers told the board, and (iii) the bribery was so pervasive that the board must have known. The 8th Circuit rejected the first account after determining that the audit committee's obligation to report to the board alone did not make it reasonable to infer that the board received and read the report of the bribery investigation. The court likewise rejected the second and third theories because no specific allegations supported a reasonable inference that the board members were informed of the potential bribery before it was disclosed in the press.

Therefore, the court concluded that the plaintiffs did not establish with particularity that much of the retailer's board was incapable of fairly considering whether to pursue the claims.

Dodd-Frank Act

DC Circuit Rules That CFPB Single-Director Structure Is Unconstitutional

PHH Corp. v. Consumer Fin. Prot. Bureau, No. 15-1177 (D.C. Cir. Oct. 11, 2016)

A split panel of the D.C. Circuit held that the Consumer Financial Protection Bureau (CFPB) is unconstitutionally structured.

PHH, a mortgage lender, appealed a $109 million disgorgement order by the CFPB sanctioning PHH for engaging in a captive reinsurance arrangement. PHH raised a Constitutional challenge to the structure of the CFPB, which is led by a single director who could only be removed for cause. PHH also raised statutory challenges to the retroactive application of a new interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and to its application outside the law's three-year statute of limitations.

The court agreed with PHH's Constitutional challenge. First, the court reasoned that there is no check on the director's power, which poses a threat to individual liberty. Second, it noted that the CFPB's structure departs significantly from historical practice, where independent agencies are led by multimember commissions and executive-agency directors are removable by the president at will. Thus, the court held that the CFPB's single-director structure is unconstitutional. As a remedy, the court severed the statute's unconstitutional for-cause provision from the remainder of the statute, effectively giving the president the power to supervise, direct, and remove the CFPB director at will.

The court also agreed with PHH's statutory challenges. First, the court held that the CFPB misinterpreted Sections 8(a) and 8(c). The court held that those provisions clearly permit captive reinsurance arrangements so long as the mortgage insurer pays reasonable market value for the reinsurance provided. Second, the court held that the CFPB violated due process principles when it retroactively applied a new interpretation of Section 8 to conduct that occurred before the CFPB issued its new interpretation. Third, the court held that the Dodd-Frank Act incorporates the statutes of limitations in the underlying statutes enforced by the CFPB in administrative proceedings and, under RESPA, the three-year statute of limitations applies to all CFPB enforcement actions, whether in court or administratively.

Judge Karen L. Henderson, concurring in part and dissenting in part, wrote that the majority could have granted PHH full relief on statutory grounds alone and therefore "unnecessarily reach[ed] PHH's [C]onstitutional challenge."

Judge A. Raymond Randolph concurred in the decision, writing that the administrative law judge (ALJ) who presided over the hearing was, as the CFPB director later affirmed, an "inferior Officer" within the meaning of Article II, Section 2, Clause 2 of the U.S. Constitution. As such, the ALJ should have been appointed by the president; because he was not, the proceedings against PHH were unconstitutional.

ERISA

Second Circuit Affirms Dismissal of Claims Against Fiduciaries of ERISA Plan

Loeza v. Doe, No. 16-222-cv (2d Cir. Sept. 8, 2016)

The 2nd Circuit affirmed in a summary order the dismissal of claims alleging that certain individuals associated with an investment bank and a corporate retirement plan breached their duty of prudence owed under the Employee Retirement Income Security Act (ERISA). The plaintiffs, current and former employees of the investment bank, participated in the bank's 401(k) savings plan, which, because the plan owned shares of the bank, qualified as an employee stock ownership plan under ERISA. The plaintiffs alleged that the defendants were imprudent by failing to prevent the plan from purchasing the investment bank's stock at a price that was artificially inflated by an alleged securities fraud related to trading activity by the investment bank's chief investment officer. The plaintiffs claimed that the defendants, as fiduciaries, should have publicly disclosed those alleged violations or at least frozen the fund's purchases of the investment bank's stock. The trial court dismissed the allegations, finding that the complaint "failed to plausibly allege that a prudent fiduciary could not conclude that freezing purchases or disclosing the alleged securities fraud would cause the Fund 'more harm than good,'" as required by U.S. Supreme Court precedent to state a claim under ERISA, as all the plaintiffs alleged was the unsubstantiated assertion that the longer the fraud went unreported, "the more painful the [stock price] correction would be." The 2nd Circuit agreed, concluding that the allegations were "wholly conclusory."

Exchange Act

Second Circuit Affirms Partial Final Judgment, Endorsing 'Inflation-Maintenance' Theory of Securities Fraud Liability

In re Vivendi S.A. Sec. Litig., No. 15-180-cv(L) (2d Cir. Sept. 27, 2016)

The 2nd Circuit affirmed a partial final judgment upholding a jury verdict in favor of the plaintiffs on claims that a media company violated Section 10(b) of the Securities Exchange Act by misrepresenting the company's liquidity risks prior to the company's liquidity crisis. The plaintiffs alleged that the company allegedly misled investors as to the company's prospects, especially with respect to the company's ability to meet its financial obligations stemming from numerous high-dollar acquisitions the company made within a two-year period. At trial, the plaintiffs proffered an expert who offered an event study purportedly demonstrating the extent to which the company's stock price was artificially inflated during the class period because of the market's mistaken belief that the company was not facing a liquidity crisis. The company challenged the expert's opinion on several grounds, including that the opinion was unreliable because it failed to show that forty-two of the fifty-seven alleged misstatements were associated with an immediate increase in price inflation and therefore had no impact on stock price. The company further argued that the plaintiffs' case rested on an impermissible "inflation maintenance" theory, which posited that statements merely maintaining an already inflated stock price are nevertheless actionable under the securities laws.

The court upheld the plaintiffs' inflation maintenance theory, concluding that "it is hardly illogical or inconsistent with precedent to find that a statement may cause inflation not simply by *adding* it to a stock, but by maintaining it." Accordingly, the court determined that the district court had not abused its discretion in admitting the testimony of the plaintiffs' expert on damages and loss causation. The court first acknowledged that the expert's opinion did not purport to (i) prove that the market's misapprehension of the company's true liquidity risk was caused only by the company's alleged fraud, or (ii) attribute price inflation to any specific alleged misstatements at the time they were made. The court, however, explained that artificial inflation is not necessarily induced by fraud because a falsehood can exist in the market for reasons unrelated to the alleged fraudulent conduct. The court rejected the company's argument that a statement must be associated with an increase in inflation to show a price impact for purposes of showing reliance or causation. The court reasoned that the price impact requirement solely concerns whether the alleged misrepresentation affected the market price, not just whether there was an increase in inflation. Further, the court rejected the company's argument that pre-existing inflation would have persisted even if the company had been silent. Among other reasons, the court noted that the price of the company's stock could have dissipated gradually if the company's silence was perceived by the market as an admission regarding the company's liquidity position. The court therefore concluded that a material misstatement does not simply maintain inflation but rather prevents the pre-existing inflation in a stock price from dissipating.

Fiduciary Duties

Delaware Court of Chancery Dismisses *Caremark* Claims Relating to Check-Cashing Business

Reiter v. Fairbank, C.A. No. 11693-CB (Del. Ch. Oct. 18, 2016)

A stockholder of Capital One Financial Corporation brought derivative claims asserting that the Capital One directors breached their fiduciary duties by disregarding their responsibility to oversee Capital One's compliance with the Bank Secrecy Act and other anti-money laundering laws (together, BSA/AML) relating to services Capital One provided to clients engaged in check cashing. After obtaining books and records pursuant to 8 Del. C. Section 220, the plaintiff filed a complaint derivatively on behalf of Capital One asserting oversight claims for breach of the fiduciary duty of loyalty. Defendants moved to dismiss the complaint pursuant to Court of Chancery Rules 23.1 and 12(b)(6).

Chancellor Andre G. Bouchard dismissed the complaint pursuant to Rule 23.1, finding demand was not excused with respect to the plaintiff's "quintessential *Caremark* oversight claim." The court rejected the plaintiff's contention that the numerous reports provided to the board over a three-year period regarding BSA/AML compliance risks constituted "a series of red flags that should have triggered a duty for the board to act." The court instead held that, "[g]iving plaintiff all reasonable inferences, the allegations of the Complaint plead at most flags of a different hue, namely yellow flags of caution concerning the Company's escalating AML compliance risk that was occurring in tandem with heightened regulatory scrutiny of AML compliance in the financial services industry," and noted that the reports to the board "explained to the directors in considerable detail on a regular basis the initiatives management was taking to address those problems and to ameliorate the AML compliance risk." The court held that "the allegations of the Complaint and the documents incorporated therein would allow reasonable minds to argue either side of a debate over whether the directors' oversight of the Company's BSA/AML compliance program was sufficiently robust or flawed. But what those allegations do not reasonably permit. . .is an inference that the defendants *consciously* allowed Capital One to violate the law to sustain a finding they acted in bad faith." Thus, the Court concluded that "plaintiff has failed to allege facts from which it reasonably may be inferred that the defendants consciously allowed Capital One to violate BSA/AML statutory requirements so as to demonstrate that they acted in bad faith," and dismissed the complaint.

Delaware Court of Chancery Dismisses Post-Closing Damages Claims Under *Corwin v. KKR Financial Holdings Framework*

In re OM Grp., Inc. Stockholders Litig. C.A. No. 11216-VCS (Del. Ch. Oct. 12, 2016)

The plaintiffs, former stockholders of OM Group, Inc., challenged OM's merger with Apollo Global Management, LLC as a product of breaches of fiduciary duty by the OM board of directors. After a majority of OM stockholders approved the merger, and the merger closed, the defendants moved to dismiss.

The Court of Chancery granted the defendants' motion to dismiss, finding that, while "[t]he Complaint sets forth a disquieting narrative" of the process leading to the merger, under *Corwin v. KKR Financial Holdings, LLC*, the complaint "must be dismissed because many of the fully informed, non-coerced, disinterested stockholders voted to approve the merger and Plaintiffs have not alleged that the transaction amounted to waste." The court found that, post-*Corwin*, "[i]n the wake of disinterested stockholder approval of a merger not subject to the entire fairness standard, a plaintiff seeking to hold directors individually liable for approving the merger must take either or both of two paths to overcome a motion to dismiss: (1) demonstrate that the transaction amounted to corporate waste; or (2) demonstrate that the stockholder vote was uninformed or coerced." Because the plaintiffs had not adequately pleaded that there were any materially misleading disclosures or material omissions about the stockholder vote, the business judgment rule applied, and the plaintiffs failed to allege that the merger amounted to waste. Therefore, they did not overcome the presumption of the business judgment rule. In dismissing the complaint, the court concluded that the "OM stockholders' fully informed, disinterested and non-coerced approval of the Merger Agreement cleansed any failure of the OM Board to act reasonably to seek the transaction offering the best value reasonably available."

Delaware Court of Chancery Dismisses Complaint Challenging Take-Private Transaction

In re Books-A-Million, Inc. Stockholders Litig., Consolidated C.A. No. 11343-VCL (Del. Ch. Oct. 10, 2016)

Vice Chancellor J. Travis Laster dismissed a stockholder complaint challenging the take-private transaction of Books-A-Million, Inc., by its controlling stockholders through a squeeze-out merger, finding the transaction was governed by the rule set forth in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

In connection with the transaction, the company formed a special committee of independent directors to evaluate the controlling stockholders' proposal, which was made contingent at the outset on the approval of a majority of the company's minority stockholders. The special committee, assisted by financial and legal advisors, considered alternative transaction structures, including a leveraged recapitalization or special dividend, but ultimately determined to pursue the take-private transaction, which was subsequently approved by a majority of the company's minority stockholders.

Reaffirming that compliance with the standard set forth in the Delaware Supreme Court's decision in *Kahn* can be tested on a motion to dismiss, Vice Chancellor Laster concluded that the allegations of the complaint did not support a reasonably conceivable inference that any of the conditions set forth in *Kahn* were not met. In particular, the controlling stockholders conditioned the transaction upon the approval of an independent, adequately empowered special committee, as well as the non-coerced, informed vote of a majority of the minority stockholders. Moreover, the complaint failed to plead that the members of the special committee were interested in or lacked independence with respect to the transaction; that the special committee was not empowered to select its own advisors and to "say no definitively" to a transaction; or that the special committee breached its duty of care throughout the process. Thus, the business judgment rule governed. Because "it [was] not possible to infer that no rational person acting in good faith could have thought the Merger was fair to the minority," Vice Chancellor Laster dismissed the complaint.

Delaware Court of Chancery Dismisses Disclosure Claims in Post-Closing Damages Action

Nguyen v. Barrett, C.A. No. 11511-VCG (Del. Ch. Sept. 28, 2016

In litigation arising out of AOL, Inc.'s acquisition of Millennial Media, Inc., Vice Chancellor Sam Glasscock III granted the defendants' motion to dismiss disclosure claims, many of which had previously formed the basis of a prior request for a preliminary injunction.

With respect to disclosure claims that had been the subject of the motion for a preliminary injunction—including that the defendants failed to disclose certain components of the unlevered free cash flow used by Millennial's financial advisor, LUMA Securities LLC, about the analyses that formed the basis of its fairness opinion—Vice Chancellor Glasscock granted the motion to dismiss, noting that such claims did not "constitute a material lack of disclosure." He further explained that at the motion to dismiss stage, an argument that disclosure claims were material is even more difficult to plead than at the preliminary injunction stage, because a plaintiff must plead not only that an omitted disclosure was material, but that the defendant directors' purported breach of duty would not be exculpated, meaning "it is reasonably conceivable that the allegedly incomplete disclosure was made by the board disloyally or in bad faith . . ."

With respect to disclosure claims that had not been raised at the motion for a preliminary injunction hearing—including that defendants failed to disclose the amount of LUMA's fee that was contingent upon the completion of the transaction—Vice Chancellor Glasscock considered the defendants' argument that the claims should be deemed waived, explaining that "where a plaintiff has a claim, pre-close, that a disclosure is either misleading or incomplete in a way that is material to stockholders, that claim should be brought pre-close, not post-close," because "a stock-holder's right to a fully informed vote" will be "irretrievably lost following a stockholder vote. The preferred method for vindicating truly material disclosure claims is to bring them pre-close, at a time when the Court can insure an informed vote. Because of this interest, a salutary incentive could be provided by considering claims based on disclosure, pled but not pursued pre-close, to be waived." However, Vice Chancellor Glasscock ultimately agreed with the defendants that the plaintiffs failed to state a claim and accordingly declined to reach the waiver argument.

Forward-Looking Statements

SDNY Dismisses Putative Class Claims Against Computer Technology Company in Wake of $2.4 Billion Write-Down

Int'l Ass'n of Heat & Frost Insulators & Asbestos Workers Local #6 Pension Fund v. IBM, No. 15cv2492 (S.D.N.Y. Sept. 7, 2016)

Judge William H. Pauley III dismissed claims that a computer technology company and certain of its executive officers violated Section 10(b) of the Securities Exchange Act by misleading investors prior to the company's $2.4 billion write-down incurred in selling a semiconductor unit at a loss. The plaintiffs alleged that the company's financial statements did not comply with generally accepted accounting principles (GAAP) because prior to selling the semiconductor unit, the company failed to account for the unit as an impairment. Although the company contended that it could not independently account for the semiconductor unit as an independent impairment loss because it was vertically integrated into the business, the court disagreed because the company's "own disclosures demonstrate[d] that it tracked [the semiconductor unit's] revenues" and operating losses.

However, the court dismissed the action because the plaintiffs failed to adequately plead scienter. The court rejected the plaintiffs' contention that the (i) magnitude of the write-down, (ii) unrealized forward-looking statements regarding the company's projected earnings per share, and

(iii) compliance certifications signed by the company's officers pursuant to the Sarbanes-Oxley Act—considered together—demonstrated a strong inference of scienter. Judge Pauley noted that the plaintiffs "all but concede that any of those allegations, viewed in isolation, would be insufficient to allege scienter," and that the allegations fared no better collectively. The court observed that Sarbanes-Oxley certifications do not create an inference of scienter because otherwise there would be "an inference of scienter in every case where there was an accounting error or auditing mistake made by a publicly traded company." Similarly, it noted that the company's forward-looking statements regarding its earnings per share were protected by the Private Securities Litigation Reform Act's (PSLRA) safe harbor that protects such statements unless they are made with an actual knowledge of their falsity. In sum, the court concluded that the plaintiffs had failed to allege facts demonstrating that the risk of the write-down had been so apparent that the "failure to take an earlier write-down amounts to fraud."

Third Circuit Affirms Dismissal, Holding That Forward-Looking Statements Couched in 'Meaningful Cautionary Language' Fall Under Reform Act's Safe Harbor Provision

OFI Asset Mgmt. v. Cooper Tire & Rubber, No. 15-2664 (3d Cir, Aug. 22, 2016)

The 3rd Circuit affirmed the dismissal of claims premised on an alleged misrepresentation to investors during a failed merger, holding that statements made by the company's officers were forward-looking and thus fell under the PSLRA safe harbor provision.

In 2013, two tire companies reached a merger agreement. Key to the merger was the defendant company's presence in China. However, the announcement of the merger led to a protracted strike at the Chinese facility. The company's subsequent 10-Q disclosed the "temporary work stoppage" and warned it could hurt future performance. Thus, the defendant company was asked to accept a price reduction, which it declined but did not disclose to shareholders. The company's stockholders later approved the merger, but the other party refused to close the deal because the company did not accept the price reduction. Ultimately, the company terminated the planned merger, and its stock price dropped.

The plaintiff investors subsequently filed this action, claiming that the defendant company made material misrepresentations regarding the merger.

The district court dismissed the claims, and the 3rd Circuit affirmed. The court held that the company's statements regarding the workers' strike were forward-looking because they concerned the impact labor issues might have on future business negotiations. And since those statements were accompanied by "meaningful cautionary language," they were protected under the PSLRA's safe harbor provision. Regarding the other statements at issue, the court held that the company's revenue projections were not statements of fact, and that the company was under no obligation to use adjectives (*e.g.*, "imperiled") to describe the state of the merger deal.

High-Speed Trading

Second Circuit Affirms Dismissal of High-Speed Trading Claims Against Securities Exchanges

Lanier v. Bats Exch., Inc., No. 15-1683 (2d Cir. Sept. 23, 2016)

The 2nd Circuit affirmed the dismissal of contract claims against a group of securities exchanges. The plaintiff—a subscriber to data feeds through which the defendants provide information about securities traded on the exchanges—alleged that the defendants had impermissibly provided a group of preferred customers with faster access to data. Those preferred customers allegedly paid to receive the data directly from an exchange's proprietary feed rather than receiving consolidated data from the processor. The defendants were regulated by Securities and Exchange Commission (SEC) Regulation NMS, which requires the defendants to file a transaction reporting plan (NMS Plan) with the SEC for approval, which must provide for the dissemination of data "on terms that are not unreasonably discriminatory." The plaintiff argued that his subscriber agreements with the defendants incorporated the relevant SEC regulations, and a breach of the SEC regulations constituted a breach of contract.

The 2nd Circuit first held that it had subject matter jurisdiction to hear the case, reversing the district court, because the Securities Exchange Act evinced no congressional intent for the SEC to review private contract disputes, an area outside the SEC's competence and expertise. Nonetheless, the court held that the complaint failed to state a claim because the contract claims were pre-empted by SEC regulations, which require only that data be sent by exchanges at the same time, not that it be received simultaneously by all users. The court declined to adopt a contrary interpretation of the defendants' duties under state law because doing so would frustrate the Securities Exchange Act's purpose of creating a uniform national market system. Further, the court reasoned that the plaintiff's contention that preferred customers should not receive data prior to the processor had no basis in the subscriber agreement, which simply required that the exchange deliver data in a manner consistent with its NMS Plan. Finally, the court held that to the extent that the complaint alleged that the defendants committed a breach because the implementation of their respective NMS Plans violated the Securities Exchange Act, that claim had to be administratively exhausted before the SEC.

Loss Causation

District Court Holds Anonymous Blog Post Comprised of Already Public Information Does Not Constitute Corrective Disclosure

Bonanno v. Cellular Biomedicine Grp., Inc., No. 15-cv-01795-WHO (N.D. Cal. Sept. 2, 2016)

The Northern District of California dismissed a putative securities fraud class action, holding that an anonymous blog post that merely compiled already public information could not constitute a corrective disclosure sufficient to show loss causation.

The plaintiffs, shareholders of a biotechnology company, alleged that the company and its investor relations firms made inadequate and obfuscated disclosures regarding the company's payments for promotions in a scheme to raise the company's stock price. The plaintiffs claimed that the truth regarding this fraudulent scheme was revealed to the market in an anonymous blog post to a financial news and analysis website. In the post, the blogger collected a variety of public information regarding the company, its alleged misconduct and its paid promotion campaign, and predicted a "-94.6% near term and imminent downside" for the company's shares.

The court dismissed the complaint for failure to adequately plead loss causation. The court held that plaintiffs did not allege how the blog post constituted a corrective disclosure of "true facts" that were not previously publicly available, as is required to plead loss causation. The court emphasized that while the blog post compiled a host of information in one place, none of the information was new or nonpublic prior to the post. The court explained that aggregating and publishing old information is never sufficient to satisfy the loss causation standard because an efficient market would have already digested the information. The court found it irrelevant that information about the promotion payments came from noncompany sources rather than the company's public filings.

Sarbanes-Oxley Act

Ninth Circuit Finds Implied Truth Requirement in Rule 13a-14 Certifications, Holds Corporate Officers May Be Subject to Disgorgement Remedy Even Absent Proof of Wrongdoing

U.S. Sec. & Exch. Comm'n v. Jensen, No. 14-55221 (9th Cir. Aug. 31, 2016)

The 9th Circuit reversed a district court judgment in favor of defendant corporate officers, holding that (i) Rule 13a-14 of the Securities Exchange Act provided the SEC with a cause of action against corporate officers who certified false or misleading statements, and (ii) the Sarbanes-Oxley Act's disgorgement remedy applied even if the officers were not involved in the misconduct necessitating a restatement.

The SEC sued the former CEO and chief financial officer of a water treatment company, alleging that the officers defrauded investors by reporting millions of dollars in revenue that were never realized. The officers had signed SEC filings on behalf of the company containing the company's financial statements. The SEC alleged that the company's financials did not comply with GAAP and, due to the inflated revenues, the defendants undeservedly earned substantial incentive-based compensation. After the defendants left the company in 2008, the company restated its financial statements for 2006 and 2007, causing a substantial drop in stock price. The SEC sought to hold the defendants liable for the misstated revenue and have their performance-based incentives disgorged pursuant to Sarbanes-Oxley.

Rule 13a-14 requires a company's principal executive and financial officers to certify in each periodic SEC report that they have reviewed the report and that, based on their knowledge, it does not contain any material untrue statement or omit any material facts. The court held that under that rule, an officer cannot comply with Rule 13a-14 simply by signing the periodic certifications; the filing must also be truthful for an officer to be compliant. The court declined to determine what mental state was required when signing a false certification to violate Rule 13a-14, meaning that a future court will need to determine whether an officer must have knowledge that the filing is untruthful at the time of signing.

The court also held that Sarbanes-Oxley's disgorgement remedy simply required misconduct by the issuer; personal misconduct by the CEO or CFO was irrelevant. While numerous district courts have reached this conclusion, the 9th Circuit was the first circuit court to rule on this issue. The court thus vacated the district court opinion and remanded the action.

Scienter

First Circuit Affirms Dismissal of Securities Fraud Claims Against Vertex Pharmaceuticals Based on Announcement of Erroneous Interim Trial Results

Local No. 8 IBEW Ret. Plan & Trust v. Vertex Pharm., Inc., No. 15-2250 (1st Cir. Oct. 3, 2016)

The 1st Circuit affirmed the dismissal of a putative class action complaint alleging that Vertex Pharmaceuticals violated Section 10(b) of the Securities Exchange Act in connection with the announcement of interim results of a trial. The complaint alleged that the results, which involved the combination of two drugs, overstated the improvement in lung function among patients receiving the treatment. Vertex allegedly announced positive interim results but then issued a subsequent press release stating that the prior announcement had overstated results due to a "misinterpretation" of the data Vertex had received from its third-party vendor. The plaintiffs alleged that before the second announcement, five individual defendants sold $32 million worth of the company's stock. One such defendant allegedly retired shortly after the second press release and one day after a U.S. senator sent a letter to the SEC asking it to probe whether any insider trading had occurred at Vertex.

The court held that the complaint failed to allege facts giving rise to the requisite strong inference of scienter. The court reasoned that although the results demonstrated an absence of improvement in one of the two key measures of lung function, there was no allegation that this was incompatible with improvements in the second measure.

Further, there was no "glaring" incongruity in the results which would make the need for further inquiry obvious. Importantly, there was no allegation that anyone at Vertex responsible for receiving, reviewing or reporting the results had in fact noticed an error in interpretation before the discovery that led to the second announcement or received the raw data. Although the complaint alleged that the error in the results was so fundamental that it should have been obvious to the Vertex pulmonologist reviewing the raw data, the pulmonologist had not been named a defendant, and there was no allegation that he had any responsibility for the decision to announce the interim results.

The court also rejected the argument that the timing of the defendants' sales of stock was indicative of scienter. First, two of the six individual defendants (the director and the CEO) had not engaged in any inconsistent trading behavior during the class period. Thus, the court rejected the inference that the error was obvious to all defendants because it was implausible that the director and the CEO, who did not trade, would have gone along with the decision to announce the clearly flawed results. Second, the court determined that the plaintiffs had not sufficiently alleged that the error in the results would have been apparent only to the defendants who allegedly made unprecedented sales. The court similarly declined to infer any misconduct based on the executive's allegedly sudden retirement, reasoning that there were various alternative explanations for the departure and that any inference of scienter would depend "on a degree of guesswork inconsistent with the PSLRA pleading standard."

Second Circuit Affirms Dismissal of Securities Fraud Claims Against BlackBerry but Vacates Denial of Motion for Leave to Amend Complaint

Cox v. BlackBerry Ltd., No. 15-3991 (2d Cir. Aug. 24, 2016)

The 2nd Circuit affirmed the dismissal of a putative securities fraud class action against BlackBerry Ltd., arising out of allegations that the defendant made material misstatements and omissions concerning the release of the BlackBerry Z10 smartphone. The court affirmed the district court's ruling that the complaint failed to allege the requisite strong inference of scienter. The court reasoned that certain individual defendants' high ranking within the organization—the president and CEO on the one hand and the chief financial officer on the other—was insufficient on its own to establish scienter. Even though the complaint alleged that the two had monitored the sales and returns of the Z10 smartphone, it contained no specific facts demonstrating that they in fact possessed information contrary to their public statements about the release of the smartphone. The court rejected the plaintiffs' "fraud by hindsight" theory that rested on the premise that "because the release of the Z10 ultimately turned out to be a failure, defendants must have known that it would be a failure and lied about this fact to investors."

However, the 2nd Circuit vacated the district court's denial of the plaintiffs' motion for leave to amend based on two events that postdated the dismissal of the complaint. First, the U.S. Supreme Court issued its decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), which refined the standard for liability for statements of opinion. Second, the plaintiffs discovered evidence that allegedly corroborated a third-party research report showing that customer returns of the Z10 were outpacing sales and arguably demonstrating that the defendants' statements of opinion concerning the veracity of the report had no reasonable basis. The court vacated the order denying leave to amend, finding the district court's reasoning to be vague, and directed the court to reconsider and explain the basis for its decision.

District of Connecticut Court Dismisses Claims Against Educational Financial Services Company

Perez v. Higher One Holdings, Inc., No. 3:14-cv-755(AWT) (D. Conn. Sept. 13, 2016)

Judge Alvin W. Thompson dismissed putative class claims that an educational financial services company and certain of its current or former executives and/or directors violated Section 10(b) of the Securities Exchange Act by misleading investors with respect to (i) the company's legal compliance, (ii) its reporting of its financial and operating results, (iii) its termination of a certain banking partnership, and (iv) its internal controls over financial reporting and disclosure. The complaint did not adequately allege facts demonstrating an actionable misstatement or omission. The court found that statements about the company's legal compliance were not misleading because they amounted to "corporate puffery," even though the plaintiffs offered confidential witness statements from witnesses attesting that the company did not appropriately revise its compliance practices following a Federal Deposit Insurance Corporation consent order. The court discredited those confidential witness statements because they were not alleged to come from employees who worked in compliance. The court noted that the witness statements demonstrated "only that the individual CWs themselves did not know of revisions to the compliance management system, not that [the company] failed to revise the system."

Similarly, although plaintiffs alleged that the company failed in certain public filings to disclose that the company had not complied with all applicable laws, the court observed that those statements were made days before the Federal Reserve initiated an enforcement action against the company. Moreover, the court rejected the argument that "[d]efendants had a duty to disclose the existence of improper business practices prior to any indication that those practices were under scrutiny." The court likewise rejected the plaintiffs' allegation that the defendants made false and misleading statements about the reasons why the company's relationship with a certain bank was terminated, stating that even if the bank terminated its relationship with the company because the company engaged in improper conduct, "the securities laws do not impose a general duty to disclose corporate mismanagement or uncharged criminal conduct." Finally, the court rejected the plaintiffs' allegations that the company's statements about its internal controls over financial reporting were misleading, holding that the plaintiffs had failed to allege facts demonstrating that the company believed that its internal controls were ineffective, "even if this conclusion was later proved to be erroneous."

SEC Administrative Proceedings

DC Circuit Finds SEC Administrative Proceedings Constitutional

Raymond J. Lucia Cos. v. Sec. & Exch. Comm'n, No. 15-1345 (D.C. Cir. Aug. 9, 2016)

The D.C. Circuit held that the administrative law judges (ALJs) working for the SEC are not "inferior Officers" subject to the requirements of the Appointments Clause under Article II, Section 2, Clause 2 of the U.S. Constitution. In so holding, the court became the first federal appellate court to rule on the merits of a Constitutional challenge to the SEC's ALJs.

Petitioners, an investor and his investment companies appealed to the SEC the decision of an ALJ holding them liable for violations of the anti-fraud provisions of the Investment Advisers Act. The SEC conducted an independent review and ruled against the petitioners, rejecting their argument that the administrative proceeding was unconstitutional because the presiding ALJ was not appointed in accordance with the Appointments Clause. The SEC issued an order imposing sanctions on the companies and a lifetime ban on the investor for making misleading statements about their investment strategy.

Petitioners sought review in the D.C. Circuit, contending that the SEC's decision and order should be vacated because the ALJ who rendered the decision was an inferior Officer who was not appointed pursuant to the Appointments Clause. The court disagreed. Quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976), the court held that an appointee is an inferior Officer under the Constitution if the appointee exercises "significant authority pursuant to the laws of the United States." Relying next on *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000), the court held that an appointee exercises "significant authority" if three criteria are met: (i) the matters resolved by the appointee are significant, (ii) the appointee exercises significant discretion in reaching decisions, and (iii) the decisions are final.

The court held that because the ALJs' decisions are not actions of the SEC unless the SEC issues a finality order, the ALJs' decisions are not independently final. Therefore, SEC ALJs do not satisfy the third criterion of the *Landry* test and thus are not inferior Officers.

Securities Fraud Pleasing Standards

District Court Denies Shareholder's Claim for Relief Based on 'Newly Discovered' Evidence

Messner v. USA Techs., Inc., No. 15-5427 (E.D. Pa. Sept. 19, 2016)

The Eastern District of Pennsylvania refused to vacate an earlier dismissal of a securities fraud lawsuit based on the plaintiff's claim of "newly discovered" evidence, holding that the plaintiff failed to exercise reasonable due diligence in investigating the defendant before filing the original suit.

The plaintiff initially filed suit on October 1, 2015, alleging that the defendants made false and materially misleading statements regarding the company's accounting practices and internal controls. The court dismissed his claims on April 13, 2016. Four months later, the plaintiff sought relief from the court, claiming he had discovered new evidence—a May 2, 2016, third amended complaint by another party against the company, alleging a similar lack of internal controls.

The court denied the plaintiff's request for relief. The court noted that an amended complaint in the other matter was filed on April 10, 2015, almost six months prior to the plaintiff here, alleging the same shortcomings regarding the company's internal controls. The court determined that the April 10, 2015, amended complaint put the plaintiff on notice of the supposed "new" evidence. Accordingly, the plaintiff failed to "satisfy his heavy burden under [Federal] Rule [of Civil Procedure] 60(b)(2) of demonstrating he exercised reasonable diligence." Furthermore, the plaintiff failed to "demonstrate exceptional circumstances warranting relief from judgment under Rule 60(b)(6)."

Loss Causation

Sixth Circuit Reverses Dismissal of Securities Fraud Claims Against Federal Home Loan Mortgage Corporation and its Senior Officers

Ohio Pub. Emps. Ret. Sys. v. Fed. Home Loan Mortg. Corp., No. 14-4189 (6th Cir. July 20, 2016)

The 6th Circuit reversed the Northern District of Ohio's dismissal of a putative class action brought by a state pension fund against Federal Home Loan Mortgage Corporation (Freddie Mac) and four of its senior officers for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act and SEC Rule 10b-5. The plaintiff alleged that Freddie Mac had made materially false statements and omissions that concealed (i) its overextension in the nontraditional mortgage market, (ii) its materially deficient underwriting, risk management and fraud detection practices, and (iii) its financial health. Proceeding under the "materialization of risk" theory of loss causation, the plaintiff claimed that it suffered foreseeable losses due to the drop in the market price of Freddie Mac's stock when these risks were realized. The district court granted the defendants' motion to dismiss, rejecting the plaintiff's materialization of the risk theory for loss causation and concluding that the plaintiff failed to plead loss causation.

The 6th Circuit reversed the dismissal and held that materialization of the risk was a viable theory for alleging loss causation. Reasoning that its prior decisions recognized the viability of alternative theories of loss causation, the court joined many other circuits in recognizing and adopting materialization of the risk as an alternative theory for loss causation. Specifically, the court adopted the materialization of the risk theory as set forth by the 2nd Circuit in the *Omnicom* case, which provides that a plaintiff may show loss causation by alleging "proximate cause on the ground that negative investor inferences," drawn from a particular event or disclosure, "caused the loss and were a foreseeable materialization of the risk concealed by the fraudulent statement." *In re Omnicom Grp., Inc. Sec. Litig.*, 597 F.3d 501, 511 (2d Cir. 2010). Applying this theory, the court concluded that the plaintiff sufficiently alleged loss causation. The court found the plaintiff's allegations that Freddie Mac disregarded its internal controls, inaccurately presented its financial reports and internally recognized that its public statements were misleading were sufficiently correlated to the risks that materialized at the end of the class period and the immediate fall in stock price to support a plausible claim of loss causation.

Lastly, the court rejected Freddie Mac's argument that the plaintiff failed to plead facts sufficient to exclude more likely explanations for its alleged losses. The court reasoned that the "[plaintiff] need only allege sufficient facts to support a plausible claim—not the most likely—" to defeat a motion to dismiss. Accordingly, the court reversed.

Statutes of Limitations

Tenth Circuit Affirms Disgorgement Damages Against Investment Adviser

Sec. & Exch. Comm'n v. Kokesh, No. 15-2087 (10th Cir. Aug. 23, 2016)

The 10th Circuit affirmed the entry of judgment following a jury verdict returned in favor of the SEC involving an investment adviser who was found liable for misappropriating funds from several SEC-registered business development companies (BDCs). On appeal, the adviser argued that 28 U.S.C. Section 2462, which sets a five-year limitations period "for the enforcement of any civil fine, penalty, or forfeiture" precluded the court's imposition of disgorgement and permanent injunction from violating certain securities laws. First, with respect to the injunction, the court stated that an "order to obey the law" is not a penalty encompassed by the limitations period because "such an order is purely remedial and preventative." Similarly, with respect to disgorgement, the 10th Circuit determined that disgorgement is not a penalty under Section 2462 because it also is remedial, even though the defendant argued that the order was punitive because it required him to disgorge more than he gained himself. The court stated that there is "nothing punitive about requiring a wrongdoer to pay for all the funds he caused to be improperly diverted to others as well as to himself." The court also rejected the defendant's argument that the disgorgement order constituted an impermissible forfeiture within the meaning of Section 2462. The court noted a circuit split on the issue—with the 11th Circuit, for example, which has held that disgorgement can constitute an impermissible forfeiture—and the court noted that "in recent years some federal forfeiture statutes have been expanded to include disgorgement-type remedies." The court examined the historical meaning of "forfeiture" as well as the historical predecessors of Section 2462 and concluded that the disgorgement order was not a forfeiture because when Section 2462 was enacted, its drafters likely did not intend for the barring of forfeitures to include "traditional disgorgement remedies."

Tolling

Eleventh Circuit Holds Tolling Under American Pipe Tolling Is Equitable, Not Legal, in Nature and Does Not Apply to Section 20(a)'s Statute of Repose

Dusek v. JPMorgan Chase & Co., No. 15-14463 (11th Cir. Aug. 10, 2016)

The 11th Circuit affirmed the dismissal of a shareholder suit alleging a Racketeer Influenced and Corrupt Organizations Act (RICO) violation and Section 20(a) control person liability against an international bank for losses arising out of the Bernard Madoff scandal, holding that the RICO claim was barred by the PSLRA and that the Section 20(a) claim was time-barred and not subject to tolling under *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974).

Madoff was arrested on December 11, 2008, but the plaintiffs did not file this action until March 28, 2014. Section 20(a) has a five-year statute of repose, meaning that, absent tolling, the plaintiffs needed to bring suit by December 11, 2013. The plaintiffs argued that their claims were tolled under *American Pipe* due to a related class action against the international bank in the Southern District of New York.

In *American Pipe*, the U.S. Supreme Court held that "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." *American Pipe* was later extended to would-be class members who file separate actions after class certification is denied.

The 11th Circuit explained that while statutes of repose can be subject to legal tolling, they are not subject to equitable tolling. However, the court also noted that there is a circuit split as to whether tolling under *American Pipe* is legal or equitable in nature. The court ultimately concluded that tolling under *American Pipe* is equitable. As such, Section 20(a)'s statute of repose was not subject to tolling, and the plaintiffs' claims were time-barred.

The court also disposed of the plaintiffs' RICO claim, as the claims of mail and wire fraud were clearly based on violations of securities law. Thus, it was precluded by the PSLRA.

"A Hyphen! A Hyphen! My Kingdom for a Hyphen!"[1]

By James D. Redwood

King Richard III's memorable but vain plea for equine backup during the Battle of Bosworth Field, at which he ultimately lost not only his horse, but also his crown and his life, was a matter of much moment back in 1485. But the idea that it expressed, namely that fortunes can change dramatically based on trivialities, can aptly be applied to a recent decision by the New York Supreme Court, the Honorable Timothy S. Driscoll, J.S.C.[2] In that case, the Court had to choose between two provisions of the New York Business Corporation Law ("BCL") pertaining to the dissolution of a corporation, and the choice had an enormous impact on the remedy available to the plaintiff. It is the contention of this article that the probably inadvertent omission of a hyphen in the plaintiff's complaint led to the Court's choosing a remedy that was not within the contemplation of the plaintiff at the time he filed his action. Thus, for want of a hyphen, the day was lost.

At issue in the case was Article 11 of the BCL, which provides the framework for judicial dissolution of a corporation. The plaintiff is required in his complaint to choose the section of the statute under which dissolution is authorized and the reasons why the corporation should be dissolved.[3] If it is a shareholder (or more than one shareholder) who seeks dissolution, rather than the attorney-general[4] or the directors,[5] that shareholder (or those shareholders) must choose among three sections of the statute. The first, Section 1103, allows shareholders to present a petition for dissolution if they have adopted a resolution stating that they find the assets of the corporation to be insufficient to discharge its liabilities, or that they deem dissolution to be beneficial to the shareholders.[6] Under the second provision, Section 1104(a), the holders of shares representing one-half of the votes of all outstanding shares of the corporation may present a dissolution petition if (1) the directors are so divided that the votes required for board action cannot be obtained; (2) the shareholders are so divided that they are unable to vote for directors; or (3) there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial to the shareholders.[7] Pursuant to the third provision, New York's involuntary dissolution statute, Section 1104-a, a holder or holders of twenty percent or more of a closely held corporation's stock may present a petition for dissolution if (1) the directors or those in control of the corporation have been guilty of illegal, fraudulent, or oppressive action toward the petitioner; or (2) the property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by the directors, officers, or those in control of the corporation.[8] And finally, for purposes of later analysis, if dissolution is sought under Section 1104-a, any other shareholder(s) of the corporation, or the corporation itself, may, within ninety days of the filing of the petition, or at such later time as the court allows, elect to purchase the petitioning shareholders' shares at fair value.[9] This election is irrevocable unless the court decides otherwise.[10]

In *Cardino v. Feldman et al.*, Supreme Court was faced with the unusual situation of an apparently omitted hyphen, in an action brought, *inter alia,* for dissolution of a closely held New York corporation under the above-mentioned provisions of the BCL. The Court ultimately decided that the plaintiff's action, which first somewhat ambiguously sought a preliminary injunction and dissolution of the corporation pursuant to "§ 1104a, § 1104 and § 1115 of the Business Corporation Law ('BCL')"[11] and then later, in the Tenth Cause of Action (for Dissolution of the Corporation) sought dissolution "pursuant to NY BCL § 1104 et seq.,"[12] was really a case brought under the involuntary dissolution statute,[13] not an action for dissolution under the deadlock provision.[14] The distinction is telling, for it was clear that the plaintiff sought a court-ordered dissolution and a mandatory sale of the business to maximize the plaintiff's recovery upon leaving the corporation.[15] This would have been the appropriate remedy had the plaintiff clearly brought his action under BCL Section 1104(a). The Court, however, instead granted the defendants' motion to convert the action into one brought under Section 1104-a, and then ruled that the defendants had properly invoked Section 1118 of the statute,[16] allowing them to forestall dissolution upon electing to purchase petitioner's shares back from him at fair value. The Court candidly acknowledged that, notwithstanding the ambiguous citations to the relevant statutory authority for dissolution in the plaintiff's complaint,[17] it was choosing the buyout remedy rather than the dissolution and forced sale remedy for policy reasons. The Court reasoned that the elective buyout was "superior to dissolution because it permits the continuation of the corporation's existence."[18] The Court also found that "[t]he buyout election accommodates the interests of the respective parties in ensuring the continued functioning of the business, while also protecting the financial interest of the shareholders and creditors."[19] That may all be well and good, but it does not appear to be what the plaintiff was seeking when he filed his complaint.

I. The Case

The plaintiff, Natale F. Cardino ("Cardino"), was a fifty percent shareholder in Mana Construction Group, Ltd. ("Mana"), a New York corporation located in Jericho, New York.[20] The primary defendant, Mark K. Feldman ("Feldman"), was the other fifty percent shareholder of

Mana and its Chief Executive Officer. Mana operated a construction company, and Feldman, together with other persons not including Cardino, owned a second construction company, MP3 Construction Inc. ("MP3"). Although at all relevant times Mana apparently had in excess of millions of dollars of annual revenue, in 2014 Feldman informed Cardino that Mana was no longer profitable.

Subsequently, among other things, Feldman allegedly began to pressure Cardino to turn over some of his stock in Mana to Feldman, stopped issuing payroll checks to Cardino, and demanded that Cardino sign over his interest in Mana to Feldman. When Cardino refused, Feldman allegedly took steps to force Cardino from the workplace and "cripple him financially." These included terminating Cardino's health insurance, closing Mana's checking account, canceling Cardino's corporate email account, ceasing payments on Cardino's work vehicle, and having the vehicle repossessed. In addition, the plaintiff alleged that Feldman fraudulently conveyed assets of Mana to Feldman, his family and friends, and to MP3, essentially on a misappropriation (breach of fiduciary duty) and conversion of corporate assets theory. Among the eleven causes of action in the Verified Complaint, the one that is relevant for present purposes was the tenth, namely "a request for dissolution of the Corporation pursuant to BCL § 1104 et seq."[21]

II. Discussion

As mentioned earlier,[22] New York Business Corporation Law Section 1104(a) allows the holders of one-half of the corporation's stock to petition the court for dissolution in case of deadlock, i.e., where the directors are so divided that they cannot take proper board action, the shareholders are so divided that they cannot elect directors, or where there is internal dissension and two or more factions of shareholders are so divided that dissolution would be beneficial. Section 1104-a allows for the holders of twenty percent or more of the stock of a closely held corporation to petition the court for dissolution where those in control of the corporation have been guilty of illegal, fraudulent, or oppressive action toward the plaintiffs, or where the property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by those in control of the corporation. Pursuant to Section 1118, where dissolution is sought under Section 1104-a, but *not* under 1104(a), the corporation or any other shareholder may elect to purchase the complaining petitioner's shares at fair value, and that election is irrevocable unless the court decides otherwise. Section 1105 requires the petition to specify the section of the statute under which dissolution is sought, but in the *Cardino* case, unfortunately, the complaint was somewhat ambiguous in this regard, stating in one place that dissolution was sought under "§ 1104a, § 1104,"[23] and in another only that dissolution was sought "pursuant to NY BCL § 1104 et seq."[24] The absence of the hyphen between "1104" and "a" in the first citation, or perhaps the failure to put "a" in parentheses, was unfortunate.

The plaintiff's complaint was served on the defendants on January 4, 2016, and then, acting on what appears to be the unilateral assumption that the gravamen of the complaint was consistent with a claim of oppression under Section 1104-a, rather than a claim of deadlock under Section 1104(a), the defendants, pursuant to the procedures established in Section 1118, filed an election to purchase plaintiff's shares in Mana on January 14, 2016. Defendants then sought an order by the Court converting plaintiff's cause of action for dissolution into a petition pursuant to Sections 1104-a and 1105.[25] The Court was persuaded by the defendants' argument that the complaint sounded in oppression rather than deadlock and granted the conversion motion.[26] The effect of the Court's decision was to deny the plaintiff the opportunity to force dissolution and sale of the business. The plaintiff instead had to accept the less drastic remedy of a buyout at fair value. As a policy matter this was perhaps the right decision, but the more interesting question is whether it was right on the law.

> *"New York case law makes it clear that a court acts inappropriately when it converts a Section 1104 proceeding into a Section 1104-a proceeding over the plaintiff's objection."*

Technically, at least, it would appear not. In court the plaintiff explained that he sought dissolution because of the corporation's inability to pay its bills, not because of oppression, and he argued that as a result it was "inappropriate to convert this proceeding, *over Plaintiff's objection*, to a proceeding pursuant to BCL § 1104-a . . . ."[27] The corporation's inability to pay its debts may or may not amount to grounds for dissolution under Section 1104-a (depending on whether that inability stems from the looting, wasting, or diverting of corporate assets for non-corporate purposes by those in control of the entity), but a mere complaint that debts have not been paid would not appear to amount to deadlock as that term is used in Section 1104(a), unless the failure to pay results from an even split among the corporate decision makers, one half of them voting to pay the bills in question and the other half voting against the payments. What is more important is the fact that the plaintiff *objected* to the conversion of his claim into a Section 1104-a petition.

New York case law makes it clear that a court acts inappropriately when it converts a Section 1104 proceeding into a Section 1104-a proceeding over the plaintiff's objection.[28] To the argument that the plaintiff in *Cardino* never made it entirely clear that he was bringing his action pursuant to Section 1104, and that in the absence of such clarity a conversion order by the court is appropriate, the First Department has held that in an action alleging breach of fiduciary duty and conversion of corporate assets, the lower court erred in ruling that the accompanying dissolution allegations stated a claim under Section 1104-a, in directing the plaintiff to amend his complaint pursuant to Sections 1105 and 1106, and in allowing a forced buyout of his shares under Section 1118, where

"The failure to add the critical hyphen (or the required parentheses) may make all the difference."

the plaintiff never cited Section 1104-a as the basis for dissolution.[29] Although it may be conceded that the way Feldman allegedly treated Cardino amounted to "oppression," as that term is used in Section 1104-a(1), and that the allegedly fraudulent conveyances by Feldman of Mana's assets to himself and to related parties might fall within Section 1104-a(2), which recognizes as grounds for involuntary dissolution the diversion of corporate assets for non-corporate purposes by those in control of the corporation, it bears emphasizing that the plaintiff did not so view his claims. It is therefore at least arguable that in the *Cardino* case, the failure by the plaintiff specifically to mention Section 1104-a as the basis for his dissolution petition should have given the Court pause before it automatically agreed with the defendants and converted the petition into a claim under that section, which ultimately led to a forced buyout under Section 1118.[30] This is particularly so given the fact that the plaintiff objected to the conversion.

As an interesting sidelight, it should be noted that once the defendant in a Section 1104-a action elects to purchase the complaining shareholder's shares at fair value under Section 1118, that election "shall be irrevocable unless the court, in its discretion, for just and equitable considerations, determines that such election be revocable."[31] This provision is, of course, intended primarily to prevent the *defendant* from withdrawing the election after making it, and the courts have so held.[32] Nonetheless, there is nothing in the statutory language that would prevent the *court*, if it so chose, from revoking the election on its own initiative. A credible argument can be made that where the plaintiff: 1) does not unambiguously select Section 1104-a as the basis for dissolution; 2) denies in court that he is grounding his petition in that section; and 3) objects to the conversion of his claim into one under that section, which will force him against his will to accept a buyout under Section 1118 if the defendant elects to purchase his shares,[33] the court should find that "just and equitable considerations" exist to treat the defendant's election as revocable. Such an argument was apparently never presented to the Court, or otherwise considered by it, in *Cardino v. Feldman et al.*

III. Significance

Nevertheless, as mentioned earlier, the Court in *Cardino* was persuaded to convert the objecting plaintiff's claim into one for involuntary dissolution under Section 1104-a, ultimately forcing the plaintiff to accept a buyout, albeit at a fair price, because of the superiority of the buyout remedy to the more drastic one of dissolution and a forced sale of the business. Given the Court's stance, at least in this one case, it is incumbent upon plaintiffs, as required by Section 1105, to specify the section(s) of the BCL under which dissolution is sought and state the reasons why the corporation should be dissolved. This is a responsibility that the plaintiffs should take very seriously, lest a court with an itchy trigger finger be inclined to convert the dissolution proceeding into one which the plaintiff did not intend. The failure to add the critical hyphen (or the required parentheses) may make all the difference. As a result, plaintiffs are well advised to keep in mind Mark Twain's famous comment about the need to find *le mot (le plus) juste* when writing: "[t]he difference between the almost right word & the right word is really a large matter—it's the difference between the lightning bug and the lightning."[34]

Truer words have perhaps never been spoken.

Endnotes

1. With apologies to William Shakespeare. In Act V, Scene IV, ll. 7, 13 of *Richard III*, King Richard famously shouts, "A horse! A horse! my kingdom for a horse!" Alas, his frantic plea did not save the day for him on Bosworth Field. This article, as will be explained, could equally have been entitled, "Parentheses! Parentheses! My Kingdom for Parentheses!" and the idea would have been the same. To keep matters simple, however, the article will concentrate on the omitted hyphen.
2. *Cardino v. Feldman et al.*, Short Form Order, Index No: 602747-16, Motion Seq. Nos: 2 and 3 (TRIAL/IAS Part: 12 Nassau County August 18, 2016) (hereinafter "Short Form Order").
3. BCL § 1105. That section of the statute also requires that the complaint be verified.
4. Governed by BCL § 1101.

5. Governed by BCL § 1102.
6. BCL § 1103(a). Subsections (b) and (c) of Section 1103 discuss who may call a shareholders' meeting to consider and vote on such a resolution. Although the plaintiff in *Cardino* argued that he sought dissolution "for reasons including the Corporation's inability to pay its bills" (*see* Short Form Order, *supra* note 2, at 6), he did not cite or rely on BCL § 1103 in seeking dissolution. Thus, this provision of the BCL will not be discussed further.
7. BCL § 1104(a).
8. BCL § 1104-a (a). Subsection (b) instructs the court to consider whether liquidation is the only feasible means whereby the petitioners can obtain fair value on their investment and whether liquidation is reasonably necessary for the protection of the rights and interests of any substantial number of shareholders or of the petitioners.
9. BCL § 1118(a).
10. *Id.*
11. In ¶ 2 of the plaintiff's Verified Complaint, dated December 2, 2015 (hereinafter "Verified Complaint"). The case was initially filed in Suffolk County (Supreme Court Index Number 612905-15), but was subsequently transferred to Nassau County.
12. In ¶ 160 of the Verified Complaint.
13. BCL § 1104-a, Petition for judicial dissolution under special circumstances.
14. BCL § 1104, Petition in case of deadlock among directors or shareholders.
15. This was made clear in the Transcript of Proceedings, dated May 11, 2016 (ACTION NO. 1 INDEX NO. 604319-15, ACTION NO. 2 INDEX NO. 602747-16), at p. 18: "MR. CAPASSO [Attorney for Plaintiff, Natale F. Cardino]: '. . . our client wants it [the corporation] dissolved and sold and not have the plaintiff, you know, purchase the stock.'"
16. BCL § 1118, Purchase of petitioner's shares; valuation.
17. BCL § 1105, Contents of petition for judicial dissolution. Section 1105 places the burden upon the plaintiff to "specify the section or sections of this article under which it [the petition for dissolution] is authorized and state the reasons why the corporation should be dissolved."
18. Short Form Order, *supra* note 2, at 10.
19. *Id.*
20. All references to the facts are taken from the Short Form Order, *supra* note 2, at pp. 3-4 and may be found therein but will not be separately cited. The allegations mentioned in the Short Form Order were in turn taken from the Verified Complaint.
21. Short Form Order, *supra* note 2, at 4.
22. *See* text accompanying notes 3-10 *supra.*
23. Verified Complaint, ¶ 2, at 2.
24. *Id.*, ¶ 160, at 25.
25. Short Form Order, *supra* note 2, at 5-6.
26. *Id.* at 11.
27. *Id.* at 6 (emphasis added).
28. *Giordano v. Stark*, 229 A.D.2d 493, 645 N.Y.S.2d 517 (2d Dept. 1996); *Toscano v. Southampton Brick & Tile*, 233 A.D.2d 515, 650 N.Y.S.2d 297 (2d Dept. 1996).
29. *Fedele v. Seybert*, 250 A.D.2d 519, 673 N.Y.S.2d 421 (1st Dept. 1998).
30. *See also In re Sakow*, 746 N.Y.S.2d 159 (1st Dept. 2002) (once plaintiff's § 1104 action is dismissed for failure to meet standing requirement, court erred in *sua sponte* converting the proceeding into a § 1104-a proceeding and forcing a buyout when the plaintiff opposed the conversion and never sought the buyout remedy).
31. BCL § 1118(a).
32. *See, e.g., In re Penepent Corp.*, 96 N.Y. 2d 186, 726 N.Y.S. 2d 345 (2001); *Re Pace Photographers, Ltd.*, 163 A.D. 2d 316, 557 N.Y.S. 2d 443 (2d Dept. 1990); Smith v. Russo, 230 A.D. 2d 863, 646 N.Y.S. 2d 711 (2d Dept. 1996).
33. All of these factors were present in *Cardino.*
34. Letter to George Bainton, October 15, 1888 (quote found at http://www.twainquotes.com/Lightning.html).

James D. Redwood is a Professor of Law at Albany Law School and the Managing Editor of this *Journal.*

Committee Reports

Report of the Section Chair

This has been an exciting time for the Business Law Section. Working through our strategic plan for the Section created last year, we are looking forward to being able to provide even more value to the members of the Section.

Our substantive committees continue to lead the way in providing high quality programming for each of their topics of focus, working toward keeping their members informed and on point on the ever-changing legal landscape. The Public Utility Law Committee held an outstanding program in Albany in November, bringing many practitioners, legal counsel, and administrators from around the state together to discuss pending legislation as well as the state of the practice in their sector. The Not-for-Profit Corporations Law Committee in the Fall had an excellent teleconference on filing issues with the Department of State, 501(c)(4)s, and Religious Corporations. The Securities Regulation Committee most recently discussed SEC scrutiny of Non-GAAP financial measure disclosures and the evolution of the CFTC. If you work in these sectors, you need to be at these events.

Our Fall Meeting (discussed below), held in cooperation with the Corporate Counsel Section, was about the business of doing business. For those who could not be there in person, it's been recorded and will be replayable via webcast through the NYSBA website.

Our Winter Meeting, scheduled for January 25, 2017, will be in New York City during NYSBA's Annual Meeting week. Always prescient, we will be discussing the attorney's role in promoting a strong corporate culture in the light of crises, both internal and external. We encourage you to attend the meeting and our networking luncheon immediately following the program.

In my remaining time as Chair, I have committed to enabling and assisting our officers and committee chairs to work on best practices within our Section to provide as much value and service as we can to our members. We are constantly looking at the state of Business Law in New York and fighting to update those laws important to lawyers and the economy of New York itself. We are always looking for like-minded practitioners who are seeking to become more involved in the programs and legislative initiatives that the Section has to offer. Involvement is key to keeping our Section active and productive.

Business Law Section Meetings

On October 14, 2016, the Business Law Section held its Fall Meeting at the New York State Bar Center in Albany in conjunction with the Corporate Counsel section. "Doing Business in New York State: Challenges & Opportunities" was the theme. The Business Law Section took the morning sessions, with the first session, devoted to New York State lobbying laws, with Joshua Oppenheimer, Greenberg Traurig; Ron Kennedy, NYSBA Director of Governmental Relations; and Hermes Fernandez, Bond, Schoeneck & King, Chair, NYSBA Committee on State Legislative Policy. The panelists discussed the requirements of the law and how the NYSBA handles its lobbying activities.

The panelists in the second session, Kathleen Scott, Norton Rose Fulbright US LLP, and Tom Pitegoff, LeClairRyan, discussed several of the State's laws on doing business in New York that have requirements that may be unknown to, or have unintended consequences for, New York business people, such as provisions in the New York franchise, banking and limited liability company laws.

These sessions were provided live in Albany and webcast. The webcast was taped and the recording is for sale at www.nysba.org/Business.

The Business Law Section's next program is at the NYSBA Annual Meeting, at 9 a.m. on Wednesday, January 25, 2017, when we will have a distinguished panel of experienced practitioners, including the legendary Rodgin Cohen of Sullivan & Cromwell, Tom Baxter, former general counsel of the Federal Reserve Bank of New York, and Professor Bruce Green of Fordham Law School, a recognized expert on legal ethics. They will discuss the attorney's role in furthering a strong corporate culture. The panel will be moderated by David Glass of Macquarie Group.

If you have any questions about the Section or its committees and programs, please contact me by e-mail at sg@goldlawny.com.

Sarah Gold, Chair

Banking Law Committee

A meeting of the Banking Law Committee was held at Gallet, Dreyer & Berkey LLP in New York, New York on November 10, 2016. This was our first formal meeting since May 2016 and we had a good turnout of Committee Members both in person and via teleconference. The format of the meeting was an interactive roundtable discussion on various hot button regulatory and legal issues. Several committee members were assigned to present on the topics and then lead the conversation with the group. Materials were distributed in advance to attendees. The topics for discussion were as follows: NYS DFS Cybersecurity Rules/Privacy Shield as it affects New York Businesses using EU Data; NYS DFS AML Rules; Zombie Housing Law; Consumer Foreclosure Bill of Rights; the Beneficial Ownership Rule (FINCEN); the CFPB Structure Ruling (PHH Case); and a spirited discussion of potential regulatory consequences of the presidential election. The members were able to reinforce the scope and impacts of the matters discussed and ultimately plan action items for the future. The Committee will meet again during the NYSBA Annual Meeting in January 2017.

Tanweer Ansari, Chair

Bankruptcy Law Committee

No report submitted.

Scott Bernstein, Chair

Corporations Law Committee

No report submitted.

Richard DeRose, Chair

Derivatives and Structured Products Law Committee

No report submitted.

Rhona H. Ramsay, Chair

Franchise, Distribution and Licensing Law Committee

The Franchise, Distribution and Licensing Law Committee continues to provide informative and relevant content to its members. Recently, the Committee co-sponsored a program entitled "Transatlantic Transaction: Minimizing Risk, Maximizing Value." The program focused on legal issues affecting businesses seeking to expand internationally through a variety of different transatlantic transactional strategies: franchising, joint ventures, co-branding, and licensing. The panel discussion compared United States and English laws from the litigation and transactional perspectives, focusing on franchising, retail, and IP. The Committee and its chair are actively working on additional programs for the Spring and Summer 2017. The Committee's next meeting is scheduled for January 25, 2017 in conjunction with the NYSBA's Annual Meeting.

Justin M. Klein, Chair

Insurance Law Committee

The Insurance Law Committee met during the Business Law Section's Spring Meeting on May 13th in New York City. During the well-attended session, Committee members heard a fascinating presentation from Luke Dembosky of Debevoise & Plimpton LLP entitled "Emerging Cyber Threats and Considerations When Planning for Incident Response."

Keeping to the theme of emerging issues of interest to the insurance industry and insurance lawyers, the Insurance Law Committee will meet on January 25, 2017 during the NYSBA Annual Meeting to discuss, among other things, key trends and regulatory considerations in the insurance technology, also known as InsurTech. Members are encouraged to attend the session during the Annual Meeting, and suggested topics for future sessions are always welcome.

Marilyn A. Lion, Chair

Legislative Affairs Committee

The Legislative Affairs Committee was active during the 2016 legislative session on matters of interest to the Section. We monitored a variety of bills, circulated information for comment within the Section, and prepared memoranda in support or opposition regarding some of the bills. Among the bills we tracked were: amendments to the Non-Profit Revitalization Act ("NPRA"); employee wage liens; local development corporations; shareholder remote communication; and donor disclosure by charitable non-profits. The Committee also supported the Not-for-Profit Corporation Law Committee in its efforts regarding the amendments to the NPRA that passed the legislature in June and are currently awaiting the Governor's signature.

In furtherance of the Section's strategic plans, the Committee also prepared a charter document to more specifically describe its role and functions in the context of the existing NYSBA lobbying and legislative affairs policies and procedures.

The Committee also worked closely with NYSBA's governmental relations staff and developed communication procedures for timely notification of relevant legislative activity. The improved communication bore fruit early, as the Committee was able to review and respond quickly to issues raised during the 2016 legislative session.

The Committee maintained contact with counterpart committees in other Sections. Issues of common interest among the Sections have arisen, such as the employee wage lien bill and the publication of private foundation annual tax return notices.

Michael de Freitas, Chair

Not-for-Profit Corporation Law Committee Meeting

The Committee held a meeting on November 8, 2016. The following matters were discussed:

Report on Pending NPRA Amendments—The first item discussed was the proposed amendments to the Non-Profit Revitalization Act ("NPRA"). Since the 2016 legislative session ended in June 2016, our Committee members were active in following up on the amendments to the NPRA that passed in June. These amendments would make significant improvements to some of the unforeseen difficulties of the original NPRA and were developed with considerable input by this Committee and other key groups in New York, including our counterpart committee from the New York City Bar Association, the Lawyers Alliance of New York, the Non-Profit Coordinating Committee of New York, and the New York State Law Revision Commission. Committee members, including Mike de Freitas from our Committee, and NYSBA's governmental relations director, Ron Kennedy, continued contact with those groups and met with counsel to the Governor to provide information on the NPRA and the amendments. The amendments had not been submitted to the Governor at the time of the meeting but were submitted on November 16, 2016.

Incorporation Issues Under Existing Law—Gary Trechel and Richard DiGiovanni, staff counsel with the Department of State, discussed practice issues under the Not-for-Profit Corporation Law, including the use of corporate indicators in names, the specification of purposes in the certificate of incorporation, and the status of former "Type D" corporations under the NPRA. Mr. Trechel noted that the NPRA amendments greatly reduced the number of filing issues.

501(c)(4) Corporations and Lobbying—Mike Cooney discussed recent developments regarding 501(c)(4) social welfare organizations, including a case in New York in which it was held that a 501(c)(4) organization's solicitation activity was subject to Article 7-A of the Executive Law (which governs charitable solicitations). He also discussed the broad ethics bill in the last legislature, S. 8160, which included a requirement for broad disclosure of donors by organizations that happen to spend a small amount on lobbying.

Religious Corporations Law—Mike de Freitas and Alyssa Gross discussed the state of the Religious Corporations Law. It has been amended only in a few isolated respects over the years and in various areas is still outdated and/or does not match prevailing practice. Among the more problematic issues is the almost exclusive statutory requirement for the congregation governance model, as opposed to a board-led or pastor-led model.

Incorporation in Other Jurisdictions—Daniel Kurtz joined the meeting and led a discussion regarding the trend of incorporating outside New York. He noted that, although one of the purposes of the NPRA was to make the New York law more hospitable, the result had been the opposite. There was a general discussion about the growing trend to incorporate in Delaware and possible ramifications for not doing so.

The Committee will continue to study the above issues. Committee members were urged to make further suggestions for discussion topics for the upcoming January meeting. The meeting was duly adjourned.

Michael de Freitas, Secretary of the Meeting
Frederick Attea, Chair

Public Utility Law Committee

No report submitted (see Report of the Section Chair, above).

Mary L. Krayeske, Kevin Lang, Co-Chairs

Securities Regulation Committee

The Securities Regulation Committee has heard from a number of great speakers in the fall and winter of 2016. In September, Troy A. Paredes, former SEC Commissioner and founder of Paredes Strategies LLC, discussed the current progress of the SEC's Disclosure Effectiveness Initiative. Additionally, Drinker Biddle & Reath LLP partner and former counsel and senior adviser to SEC Commissioner Luis A. Aguilar, Marc A. Leaf, and associate Robert T. Esposito, provided an overview of Regulation Crowdfunding, including an analysis of recent offerings and tips for those thinking of entering the space. In October, Kirkland & Ellis LLP partners Timothy Cruickshank and Brian Hecht discussed SEC scrutiny of non-GAAP financial measure disclosures, and Latham & Watkins LLP partner Douglas Yatter, and associate Ashley Weeks, discussed the evolution of the CFTC and SEC whistleblower programs. In November, Stephen Ascher, co-chair of the Securities Litigation and Enforcement Practice at Jenner & Block, and Michael Stewart, an associate in Jenner & Block's litigation department, discussed insider trading and the *U.S. v. Salman* case, recently decided by the U.S. Supreme Court. Additionally, Yafit Cohn, a senior associate in the Public Company Advisory Practice of Simpson Thacher & Bartlett LLP, discussed the 2016 proxy season. In December, Knute Salhus, Co-Chair, Public Company Counseling Group at WilmerHale, and associate Sarah Sellers, will provide a training on 8-K issues and considerations, and in January, attorneys from Skadden, Arps, Slate, Meagher & Flom LLP will provide an update on recent securities litigation and regulatory enforcement matters.

Anastasia T. Rockas, Chair

Technology and Venture Law Committee

No report submitted.

Peter W. Rothberg, Chair

Welcome New Business Law Section Members

The following members joined the Business Law Section since the last issue of the *NY Business Law Journal*.

First District
Joshua D. Abram
Ruth Wang Arnould
Richard Bayer
William D. Becker
Michael A. Benevento
Cara Ann Bilotta
Justine J. Block
Aaron John Borden
Darren A. Bowie
John Holmes Cantrell
Sasha A. Carbone
Eugenie M. Cesar-Fabian
Dale Alexandra Cohen
Danielle Comanducci
Samuel Y. Davidson
Christopher J. Dlutowski
Michelle Ender
Seth Andrew Fersko
Amy Bowerman Freed
Seth Evan Gardner
Samuel Goldman
Richard S. Green
Rafael Francisco Guillermety
Jeff D. Karas
John A. Karol
Jason S. Koenig
Hoon Lee
Jonathan I. Levine
Rosa J. Martire
Tram N. Nguyen
Charles D. Porter
Mary Madeline Roberts
Jennifer L. Rodburg
Adam L. Rosen
Steven Hart Rotchtin
Nameer Saad Shukri
Alan M. Siegel
Landey Strongin
Andrew Troop
Joseph Vebman
Barry A. Wadler
Duane D. Wall
Jasmin Wilhelm
Yusef Zaid Windham
Xindi Wu
Huijun Yin
Anusiga Yogeswaran

Second District
Jens Ruediger Daum
Sonya Matejovic
Grace Oluyemi
Jonathan Pizarro-Ross
Veronika Reizin
Jacob Stillwell Sciandra
Marzenna Wanda Walden

Third District
Kelly Busch
Malcom M. Butehorn
Kristina Maldonado
Paul C. Montgomery
John A. Musacchio
Geoffrey E. Rosenblat
Jason Semeiks
Steven G. Thomas
F. Michael Tucker
Paul A. Wolpert

Fourth District
Alexandra Metcalfe
Christopher C. O'Brien

Fifth District
Siddharth Bahl
Kattie M. Chmielowiec
Kristoffer Peter Kiefer

Sixth District
Bradley John Moses
Carrie J. Pollak

Seventh District
Conor Thomas Flynn
Christine Carol Lachnicht
Stephen Maier
Robert J. Sant
Jennifer N. Weidner

Eighth District
Kelly O'Neal Adams
Kurt Albert Baumgaertner
Fatin F. Haddad
Christopher A. Karns
Shao-Hua Lo
Ethan Schweizer Notarius
Andrew J. Olek

Ninth District
Christopher Sean Coleman
Laurence D. Dobosh
Caitlin O'Meara Foran
Marc E. Foto
James P. Kelley
Matthew Aaron Lebowitz
Michael I. Meltzer
Emma Semerad
Rebecca Troutman
Paul Robert Weber

Tenth District
Reid E. Arstark
Bryan R. Denberg
Christine Isaacs
Shamara James
Jung Dong Kim
Nicholas G. Kokis
Brandon Lisogorsky
Betsy R. Mantell
Anish Mashettiwar
Gerard J. McCreight
Daniel Karl Reichelscheimer
Allison Tenenbaum
Leo Shalit
Raja Singh
Raymond Ude
Nicolle Zavadoff

Eleventh District
Xiu Mei Dong
Anthe Maria Vorkas

Thirteenth District
Necva B. Solak
Darren C. Tang

Out of State
Khwaja M. Ahmad
Emilio Jose Alvarez
Thomas James Carroll
Devin A. Cohen
Carlos G. Dalmau
Albert Diaz-Silveira
Karl Dix, Jr.
Brian Alexander Flank
Willard E. Getman
Jonathan D. Hammond
William P. Hayes
William H. Hoch, III
Nicholas Janiga
Christopher Marcus Jaquez
Shreyas Balkrishna Jhaveri
Serah Oyindamola Joshua
Nicholas G. Karambelas
Vincent M. Kiernan
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Leo Kogan
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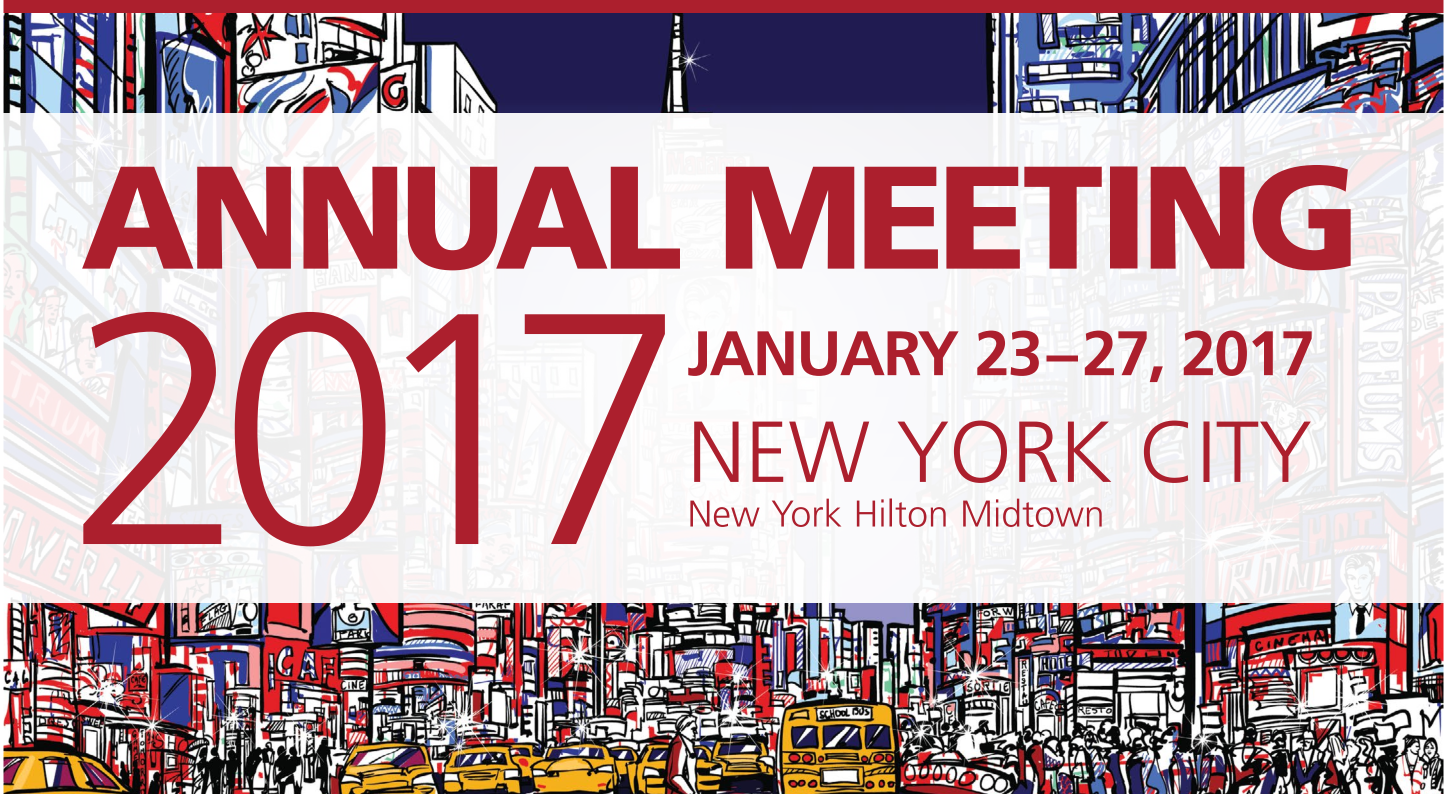

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