Securities Reform Act Litigation Reporter

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Highlights

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The most noteworthy decisions this month are the following:

• In *Hidalgo-Velez v. San Juan Asset Management, Inc.*, No. 13-1574 (1st Cir. July 9, 2014), the First Circuit ruled that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) did not apply to a case involving an investment fund that had only incidental dealings in covered securities. The court held that the tie to covered securities was too tenuous to satisfy the "in connection with" language in SLUSA. The court distinguished a case involving the Madoff Ponzi scheme because that case dealt with funds that "were marketed primarily as vehicles for exposure to covered securities." The court thus instructed the district court to return the case to the Puerto Rico court where it had originated.

• In *Spitzberg v. Houston American Energy Corp.*, No. 13-20519 (5th Cir. July 15, 2014), plaintiffs claiming they had been defrauded into buying the defendants stock in reliance on material misrepresentations concerning oil and gas "reserves" in a field in Colombia in 2009 and 2012 sufficiently pled circumstances constituting at least severe recklessness. Reversing the district court's dismissal of the complaint for failure to plead scienter, the Fifth Circuit held that the defendants' use of the industry-specific term "reserves" in a 2009 slide presentation would undoubtedly have presented an obvious danger of misleading buyers or sellers of the defendants' securities as to the value of the company's assets.

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misappropriated and diverted to TCG. Such claims of mismanagement and diversion are derivative in nature and were, therefore, were allowed to proceed.

Fraud

Finally, the Court turned to Plaintiff's individual fraudulent concealment claims against Defendant and TCG. The Court noted that, in addition to scienter, reliance, and damages, a fraudulent concealment claim must be supported by an allegation that the defendant had a duty to disclose material information and that the defendant failed to do so. A plaintiff is also required to allege the circumstances constituting the wrong in detail.

Here, Plaintiff alleged that Defendant and TCG misrepresented the true state of the assets and liabilities of the company, and made representations that the company would pay him back for the loans that he previously made. However, the Court found that such allegations were general in nature and did not provide sufficient details as to specific misstatements and misrepresentations made by Defendant and TCG. The alleged misstatements were merely futuristic and promissory in nature. The Court dismissed Plaintiff's fraud claims for failure to plead such claims with adequate specificity.

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ATTORNEY-CLIENT PRIVILEGE; INTERNAL INVESTIGATIONS

In re Kellogg Brown & Root, Inc., No. 14-5055 (D.C. Cir. June 27, 2014)

D.C. Circuit Clarifies Scope of Attorney-Client Privilege in Internal Investigations

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Taking pains to preserve corporate privileges is a fundamental component of any well run internal investigation. A recent decision by the D.C. Court of Appeals, *In re: Kellogg Brown & Root, Inc.*, No. 14-5055 (June 27, 2014), therefore provides a welcome clarification of how those protections apply in the context of an internal corporate investigation.

In *Kellogg Brown & Root*, the Court of Appeals took the unusual step of granting mandamus and vacating the lower court's order compelling the production of internal investigation materials. It did so in order to correct a decision that, if left standing, would have had, in the Court of Appeals' view, the potential to "disable most public companies from undertaking confidential internal investigations." As the D.C. Circuit explained, the lower court had so fundamentally misinterpreted *Upjohn Co.* v. *United States*, the 1981

Supreme Court precedent that first established the contours of the attorney-client privilege and attorney work product protections for corporations conducting internal investigations, that it "threaten[ed] to vastly diminish the attorney-client privilege in the business setting."

In correcting that error, the Court of Appeals provided several important clarifications regarding the scope of the *Upjohn* privilege:

- *first*, the Court rejected the lower court's conclusion that *Upjohn* did not apply because KBR's internal investigation had been conducted by in-house counsel without consultation with outside lawyers; as the Court made clear, the general rule is that a lawyer's status as in-house counsel "does not dilute the privilege;"
- *second*, the D.C. Circuit clarified that it did not matter if many of the interviews in KBR's investigation were conducted by non-attorneys, holding that "communications made by and to non-attorneys serving as agents of attorneys in internal investigations are routinely protected by the attorney-client privilege;"
- *third*, the Court also rejected the lower court's attempt to distinguish *Upjohn* on the ground that the employees interviewed by KBR had not been told that the purpose of the interview was to assist the company in obtaining legal advice; as the D.C. Circuit observed in this regard, "nothing in *Upjohn* requires a company to use magic words to its employees in order to gain the benefit of the privilege in an internal investigation;" and
- *finally*, and perhaps most importantly, the Court of Appeals overturned the lower court's finding that the *Upjohn* privilege did not apply because KBR had conducted its internal investigation in order to comply with Department of Defense regulations that require defense contractors such as KBR to maintain compliance programs and conduct internal investigations into allegations of potential wrongdoing. Observing that "the District Court's novel approach would eradicate the attorney-client privilege for internal investigations conducted by businesses that are required by law to maintain compliance programs, which is now the case in a significant swath of American industry," the Court of Appeals ruled that it is enough to trigger *Upjohn*'s protections if "one of the significant purposes of the internal investigation was to obtain or provide legal advice" and that this is true "regardless of whether an internal investigation was conducted pursuant to a company compliance program required by statute or regulation."

The opinion in *Kellogg Brown & Root* thus provides a helpful primer on the "rules of the road" for those conducting internal investigations, but it also affords a timely and important reminder to lower courts and government agencies of the centrality and scope of the corporate attorney-client privilege. As the Court concluded, the privilege "carries

costs" but our legal system tolerates those costs because the privilege also encourages full and frank communication between attorneys and their clients and thereby "promotes broader public interests in the observance of law and the administration of justice."

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