Milbank

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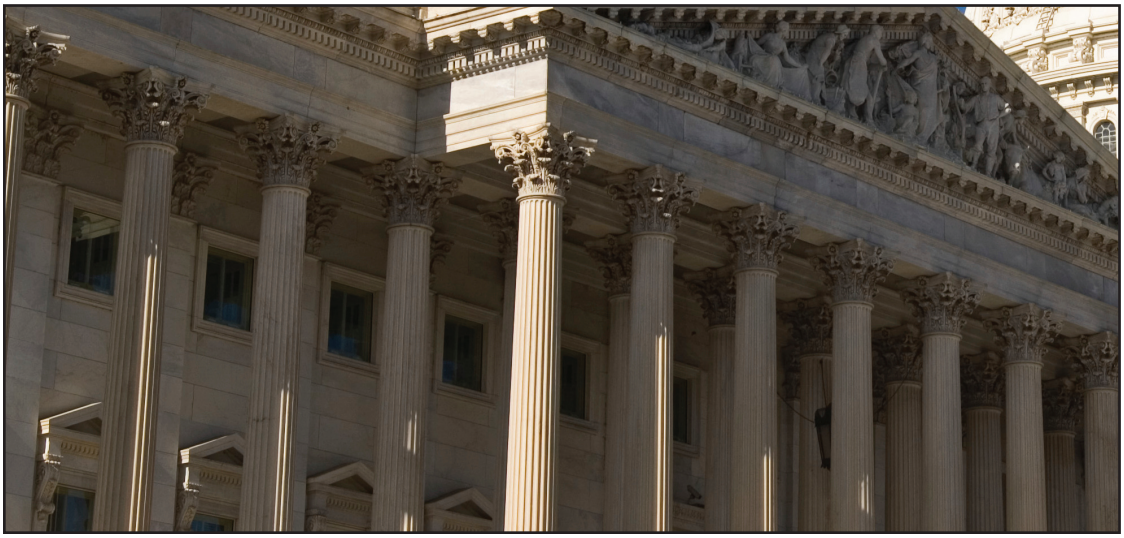

In This Issue:

BANKRUPTCY

Eighth Circuit rules Bankruptcy Code provision is unconstitutionally overbroad as applied to attorneys

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was enacted in 2005 with the intent to combat abusive pre-bankruptcy conduct that might dilute or prevent recovery by creditors in proceedings under Chapter 7 of the Bankruptcy Code. Section 526(a)(4) of the BAPCPA prohibits debt relief agencies from advising clients to incur additional debt prior to filing for bankruptcy protection, and sections 528(a)(4) and (b)(2) require those agencies to specifically disclose in their advertisements that they are a debt relief agency helping people to file for bankruptcy relief. The United States Court of Appeals for the Eight Circuit recently examined the constitutionality of those three provisions as applied to attorneys who advise debtors.

As a threshold issue, and an issue of first impression among the Courts of Appeals, the Eighth Circuit determined that attorneys who provide "bankruptcy assistance" to "assisted person[s]" fall within the Code's definition of "debt relief agencies." Relying upon the plain language of the definition and the defined terms within that definition, the Court rejected arguments to the contrary. Having concluded that attorneys may be debt relief agencies under the Code, the Court found section 526(a)(4) to be overbroad. According to the Court, insofar as section 526(a)(4) prohibited attorneys from advising debtors to incur more debt in contemplation of bankruptcy, and prevented them from fulfilling their duty to clients to provide appropriate and beneficial advice not otherwise prohibited by law, the provision imposed a restriction upon attorneys' free-speech rights. The Court recognized that there may exist scenarios in which advising a client to incur additional debt while contemplating bankruptcy could be in the interests of both the debtor and potential creditors -- *e.g.*, where a debtor sought to refinance her home mortgage for the purpose of freeing additional funds to satisfy existing debts in an attempt to avoid bankruptcy, legal advice on the refinancing would not constitute an attempt to "circumvent, abuse, or undermine the bankruptcy laws." Because Section 526(a)(4) of the Code does not account for such non-abusive scenarios, the Eighth Circuit found the provision to be "unconstitutionally overbroad as applied to attorneys falling within the definition of debt relief agencies because it is not narrowly tailored, nor narrowly and necessarily limited, to restrict only that speech that the government has an interest in restricting."

The Eighth Circuit also considered the disclosure requirements mandated by sections 528(a)(4) and (b)(2) of the BAPCPA. Recognizing the government's interest in protecting consumer debtors from deceptive advertising, the Court found that those provisions passed constitutional muster. That is, the Eighth Circuit held that section 528 requires that attorneys falling within the definition of debt relief agencies disclose "factually correct statements on their advertising," which is not violative of their First Amendment rights. (*Milavetz, Gallop & Milavetz, P.A. v. U.S.*, No. 07-2405 (8th Cir. filed Sept. 4, 2008)).

CLASS ACTIONS

Identity of confidential witnesses found to not be subject to work product protection in securities class action

Certain defendants in a class action lawsuit brought on behalf of purchasers of securities issued by Marsh & McLennan Companies, Inc. ("Marsh") moved to compel production of documents concerning seventeen confidential witnesses cited and relied upon in plaintiffs' first and second amended complaints. After a Special Master issued an order directing the lead plaintiffs to produce the documents and identify each of their confidential witnesses, lead plaintiffs filed an objection. Judge Kram of the United States District Court for the Southern District of New York affirmed the Special Master's decision and considered the circumstances in which plaintiffs must disclose the identities of confidential witnesses in discovery. As a threshold matter, the Court determined that Rule 26(b)(1) of the Federal Rules of Civil Procedure required lead plaintiffs to disclose – absent a valid claim of privilege – the identities of all confidential witnesses that were relied upon in drafting the second amended complaint, regardless of whether they intended to call such witnesses at trial. Lead plaintiffs argued that the identities of confidential witnesses were protected by the work-product doctrine and, further, that disclosure of the identities risked exposing the witnesses – some or all of whom are former Marsh employees – to possible retaliation by Marsh. The Court, in ordering the requested disclosures, noted that the identities of confidential witnesses in a securities class action enjoy limited, if any, work-product protection. Judge Kram held that even if the identities were deemed privileged, the Marsh defendants established a substantial need for disclosure under Rule 26(b)(3)(A)(ii) because they would otherwise be forced to exhaust their allotted depositions to ascertain the identities. The Court further held that fear of retaliation was not a proper basis for withholding discoverable information, and that any such concerns should be addressed in the context of a motion for a protective order limiting access to the sensitive information. (*In re Marsh & McLennan Companies, Inc.,* MDL No. 1744, No. 04 Cv. 8144(SWK) (S.D.N.Y. July 30, 2008)).

DISCOVERY AND PROCEDURAL MATTERS

Service by substitute process deemed valid where third party received actual notice

In an antitrust case pending in the United States District Court for the Southern District of New York, Judge Katz recently addressed the circumstances in which service by substitute process is permissible for a third-party subpoena. Defendants moved for leave to serve a deposition subpoena on a non-party identified by plaintiffs as a potential witness, Jack Lefkowitz, by means other than personal service. Before bringing their motion, defendants tried unsuccessfully to serve Lefkowitz personally on three occasions. Defendants first attempted to serve Lefkowitz at the address plaintiffs provided in their disclosures, but the process server was told that he was in Israel. Defendants next attempted service by delivering the subpoena to the front office of Lefkowitz's business. A front desk clerk contacted Lefkowitz by telephone, obtained his authorization to accept service, and then accepted the subpoena. When defendants' attorney subsequently called Lefkowitz to confirm the date and time of the deposition, Lefkowitz advised that he would not appear because he had not been personally served. After seeking the assistance of the Court and obtaining additional time to effect personal service, defendants made a third unsuccessful attempt at serving Lefkowitz personally. The process server again left a copy of the subpoena with the same front desk clerk, as well as with another business with which Lefkowitz was affiliated. Defendants further followed up with a letter to Lefkowitz enclosing a copy of the subpoena. Lefkowitz responded by e-mail and again refused to attend the deposition because he had not been served personally.

In reaching its decision, the Court considered the language and policy rationale of Rule 45 of the Federal Rules of Civil Procedure, which requires that a subpoena be served by "delivering a copy to the named person and, if the subpoena requires that person's attendance, tendering the fees for 1 day's attendance and the mileage allowed by law." While the majority of courts have interpreted Rule 45 to require personal service of a third-party subpoena, Judge Katz reasoned that the word "delivering" did not necessitate this interpretation. The purpose of requiring personal delivery is to ensure that the recipient will have actual notice and that enforcement of the subpoena will be consistent with due process standards. Judge Katz noted that cases in which courts have authorized alternative forms of service have emphasized the sufficiency of service where it is calculated to provide timely, actual notice. The Court concluded that Lefkowitz clearly had actual notice that defendants

sought to take his deposition and, accordingly, granted defendants leave to serve the subpoena by delivering a copy of the subpoena to Lefkowitz's place of employment, mailing a copy by first class mail, and attaching a copy of the Court's order. (*Medical Diagnostic Imaging, PLLC, et al. v. CareCore National LLC, et al.*, No. 06 Civ. 7764 (S.D.N.Y. Aug. 15, 2008)).

Electronic document production must be accompanied by some instruction and guidance even where documents are produced as maintained in ordinary course of business

During discovery in a patent infringement action pending in the United States District Court for the Northern District of New York, plaintiff produced approximately 400,000 pages of electronic documents to the defendant in 202 unlabeled computer folders. Defendant argued that the manner of production did not satisfy plaintiff's obligations under Rule 34 of the Federal Rules of Civil Procedure to organize the production to correlate to defendant's document requests or to produce the documents in the manner in which they were maintained in the ordinary course of business. Although plaintiff claimed that the documents were in fact produced as they were kept "in the ordinary course of business," defendant argued that the plaintiff was required to produce an index or other information that would demonstrate how the documents were maintained and otherwise make the production useful to the defendant. Magistrate Judge Peebles considered the discovery obligations imposed by the recently amended Rule 34(b)(2), and held that plaintiff's production did not meet its discovery obligations. The Court found that, at a minimum, the disclosing party should provide information about each document, such as the identity of the custodian or person from whom the documents was obtained, an indication of whether it was retained in hard copy or digital format, assurance that the documents has been produced in the order in which it was maintained, and a general description of the filing system from which the documents was recovered. In sum, in order to make an electronic document production meaningful, Magistrate Judge Peebles held that parties must provide their adversaries with some context to help them navigate their way through the data. (*Pass & Seymour, Inc. v. Hubbell Inc.*, No. 5:07-CV-00945 (N.D.N.Y. Sept. 22, 2008)).

REGULATORY AGENCIES

Constitutionality of Public Company Accounting Oversight Board upheld by D.C. Circuit

The United States Court of Appeals for the D.C. Circuit, in a 2-1 decision, recently upheld the constitutionality of the Public Company Accounting Oversight Board (the "Board"), established by the Sarbanes-Oxley Act of 2002 (the "Act"). The Act established the Board "to oversee the audit of public companies that are subject to the securities laws . . . in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports," and empowered the Board, subject to oversight by the United States Securities and Exchange Commission (the "SEC"), to register public accounting firms, establish auditing and ethics standards, conduct inspections and investigations of registered firms and impose sanctions. Pursuant to the Act, the five members of the Board are appointed by the SEC.

The D.C. Circuit considered appellants' arguments that because the Act does not afford adequate Presidential control over the Board and its members, it violated the Appointments Clause of the United States Constitution and the principle of separation of powers. The Appointments Clause empowers the President of the United States, with the advice and consent of the Senate, to appoint certain enumerated high-level officials, but provides that Congress may by law vest the appointment of "inferior [o]fficers . . . in the President alone, in the Courts of Law, or in the Heads of Departments." Appellants argued that due to the absence of day-to-day supervision of the Board by the SEC and the for-cause limitation on the SEC's power to remove Board members, the Board members are not inferior officers and therefore must be appointed by the President. Circuit Judge Rogers, writing for the Court, held that a determination of whether a person is an "inferior officer" rests upon whether she "ha[s] no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers." Applying this standard, the Court held that the Board's work is necessarily "directed and supervised at some level" and "subject to check by the [SEC] at every significant step."

Appellants also argued that the Act constitutes an excessive restriction of the President's control over the Board, in violation of the principle of separation of powers, by vesting the SEC with for-cause limitation on removal of the Board's members. Recognizing the Supreme Court's long history of upholding certain types of restrictions upon Presidential authority, and the fact that independent agencies like the SEC enjoy a degree of autonomy in conducting their affairs, the Court did not find the President's ability to carry out his executive responsibility to be "unconstitutionally restricted." Finding that the Act's imposition of a for-cause standard of removal did not exceed Congressional authority to impose such restrictions on removal of inferior officers, the Circuit Court found the Act did not violate separation of powers. (*Free Enter. Fund v. Public Company Accounting Oversight Bd.*, No. 07-5127 (D.C. Cir. Aug. 22, 2008)).

SEC Releases Enforcement Manual

On October 6, 2008, the U.S. Securities and Exchange Commission released publicly for the first time its manual describing the policies and practices applicable to its Division of Enforcement. The Enforcement Manual is designed to provide guidance to the Staff conducting investigations, and its publication may aid practitioners by providing greater transparency into the inner-workings of the investigative process. It generally lays out many of the long-standing practices that have been observed by the Enforcement Division, albeit with some interesting new elements.

Of particular note is the Enforcement Manual's treatment of the thorny issue of whether a company's waiver of privilege should influence the credit that it receives for cooperating with the SEC's investigation. Consistent with similar guidance recently issued by the U.S. Department of Justice (discussed in this Reporter), Section 4.3 of the Enforcement Manual confirms that the SEC does not require companies to waive the attorney-client privilege or work-product protection as a form of cooperation, as long "as all relevant facts are disclosed." The Enforcement Manual directs the Staff to not seek such waivers, and notes that waiver of privilege "is not a prerequisite to obtaining credit for cooperation." Any decisions concerning potential waivers of privilege are to be reviewed by Enforcement Division supervisors. The Enforcement Manual encourages the Staff to work with companies to explore alternative means of uncovering factual evidence where disclosure may result in a waiver of privilege.

Another important area of interest lies in the treatment of parallel investigations. The Enforcement Manual prescribes that the SEC should not conduct investigations jointly with private regulators, such as the Financial Industry Regulatory Authority, in order to avoid a possible finding that the private entity was in fact a "state actor" because of its coordination with the SEC. Similarly, the Staff is advised to maintain considerable independence from criminal authorities conducting parallel investigations, and to refuse to answer questions from defense counsel concerning the existence of criminal proceedings.

The Enforcement Manual also lays out the detailed procedures for opening investigations and for supervision of pending investigations. Enforcement Staff are required to rank investigations and identify those that are "critically important" and "significant" in order to help prioritize and manage resources. The Enforcement Manual also requires that the SEC notify subjects of investigations at the earliest time that the Staff has determined to not pursue an enforcement action. Memorializing this policy will help address the tension felt by many practitioners in determining whether to contact the SEC to check on the status of a seemingly dormant investigation. In addition, the Enforcement Manual makes clear the appropriate parameters for communications between defense counsel and senior Enforcement Staff.

WHITE COLLAR CRIME AND INVESTIGATIONS

Changes to Department of Justice's policy on corporate privilege waivers as a measure of cooperation

On August 28, 2008, the United States Department of Justice announced revisions to its guidelines concerning the circumstances in which a corporation should be charged with a criminal offense. These changes took effect immediately and were issued primarily in response to complaints from many quarters that the DOJ's previous policy unfairly forced corporations to waive attorney-client and/or work product privilege in an attempt to show that they were cooperating with the DOJ's investigative efforts. One of the key changes in the revised guidelines is that federal prosecutors will no longer be permitted to consider a corporation's waiver of privilege (or lack thereof) in deciding whether to seek an indictment. Rather, the guidelines instruct prosecutors to measure a corporation's cooperation by the extent to which it voluntarily discloses "relevant facts and evidence," regardless of whether the company waives attorney-client privilege or work product protection. Other changes imposed by the new guidelines provide that federal prosecutors may not consider whether a corporation has paid attorneys' fees for employees facing investigation or whether a corporation has entered into a joint defense agreement in evaluating corporate cooperation. Nor can prosecutors take into account whether a corporation has disciplined or sanctioned employees that are involved in an investigation.

These policy revisions will be included, for the first time, in the United States Attorneys' Manual that estabishes the DOJ's internal policies for handling both criminal and civil matters. Interestingly, the policy revisions come amid proposed legislative action on this issue, including a federal bill sponsored by Sen. Arlen Specter (R-Pa) – which is pending before the United States Senate Judiciary Committee – that would bar federal prosecutors as well as attorneys at other federal agencies from demanding that corporations waive attorney-client and work product privileges in return for leniency. Senator Specter indicated that he considers the DOJ's policy revisions to be "a step in the right direction," but noted that they leave many problems unresolved. In particular, the DOJ guidelines do not bind other federal agencies, many of which have employed similar policies concerning waivers of privilege as a factor in evaluating corporate cooperation with government investigations.

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