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# Riding the E&O Line

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Professional Liability Commitee

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Leadership Note

# From the Vice Chair

**By Melody J. Jolly**

Time flies when you're having fun! Our committee closed out 2018 with another spectacular seminar in New York City over the holiday season. It was great to see lots of familiar faces and also lots of new faces at the Professional Liability Committee annual seminar in late November. Building on a history of successful seminars, 2018 was no exception to the increased success and growth that we have seen year after year. We welcomed insurance industry professionals from across the country, who hosted panel counsel meetings over the course of three days. We heard from a stellar line-up of professionals, defense attorneys, in-house counsel and insurance executives on the latest trends in professional liability, as well as practice pointers for all non-medical professional lines. At our committee business meeting, we welcomed new faces and old friends, and jump-started our committee leadership planning for 2019. Thanks to all of you who provided feedback on the seminar—universally, the feedback has been excellent and we have received a lot of fantastic topic and speaker suggestions for future seminars.

Fresh on the heels of last year's successful Professional Liability Seminar, the committee and seminar leadership are already in full swing planning the 2019 annual seminar. After a successful inaugural Litigation Skills Workshop, held in tandem with the Insurance Law Committee (which holds its annual seminar contemporaneously with our committee's seminar each winter in New York), we are on track to host another Litigation Skills Workshop in 2019 in conjunction with the seminars in New York. The inaugural Litigation Skills Workshop was a big success; enrollment was at capacity and participants engaged in one on one and small group exercises focused on 30(b)(6) deposition techniques. We are excited that our committee will once again be able to offer attendees the opportunity to participate in this workshop, and we are working to identify a fresh topic that will enable participants to sharpen their trial skills through collaboration with one another and with seasoned, highly skilled trial attorneys. First quarter is our busy season as we are hard at work planning our committee seminar, as well as making plans for our committee fly-in meeting and our CLE and business meeting for this year's DRI Annual Meeting in New Orleans.

Speaking of the fly-in meeting, this year welcomes a change to our prior tradition of hosting the meeting at DRI headquarters in early summer and attending a Cubs game. In an effort to garner more input and involvement from our Steering Committee and membership during our busy season of seminar and annual meeting planning, we will host the fly-in meeting in March, at a location to be determined, which will be in conjunction with another DRI seminar. We love Chicago, but felt that a warmer location would be more inviting in March. As always, we will get together for dinner and networking before and after our meeting. Stay tuned for details on our Communities Page.

The continued success of this committee depends on the efforts and contributions of its members—professionals like you who take the steps to become involved in our committee's activities by writing articles, presenting webinars, participating in our DRI Community page, planning our presentations at the DRI Annual Meeting and our seminar in New York, and more. If you want to improve your knowledge about your profession and work with others who strive to do the same, please join us. Join our committee and get involved. Write articles that appear in this newsletter or other DRI publications. Meet, learn from and teach others in your profession who share your goals, interests and drive for success. Rather than just attending the Annual Meeting and our annual committee seminar, help plan them, become an author, become a presenter, become a committee leader. We are always looking for rising leaders and enthusiastic volunteers to serve on our committee, and there are always opportunities for you to get more involved. If you would like to know more, please feel free to contact me at mjolly@cshlaw.com.

As I embark on my second term as committee vice chair, I look back at all that the committee and its leaders and members have accomplished over the years. I am honored to call the intelligent, driven professionals who participate in this committee not only my colleagues, but also my friends. This committee is comprised of intelligent, driven professionals, and more importantly, people who have grown to be dear friends. I hope you'll join us on this ride.

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# Pennsylvania Joins Other States as the Latest to Reject *Garner* Standard for Derivative Plaintiffs Seeking to Pierce Attorney–Client Privilege

**By Kyle M. Heisner**

Representing corporations presents a certain peculiarity in that, while the corporation is the client, it requires individuals who are not the client to speak on its behalf. Typically, those individuals are the directors and officers of the company. This dynamic becomes obscured in the context of derivative litigation. In such cases, the dissenting shareholders or members of the corporation bring an action in the name of the corporation, but typically without holding the role of director or officer. In such cases, because the plaintiff is the "corporation," dissenting shareholders or members may argue that they are entitled to any attorney–client communications between the client—*i.e.*, the corporation—and attorneys for the corporation. Typically, however, they would not be entitled to these records outside of the context of the litigation.

The tension between the applicability of attorney–client privilege and the right of derivative plaintiffs to obtain attorney–client communications between the entity on whose behalf they are bringing the action and its lawyers was addressed in the seminal decision of *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970). In *Garner*, the Fifth Circuit created a test in which current management could assert privilege against a derivative plaintiff, but then that privilege would then be subject to an analysis under which the derivative plaintiff would be required to show that they had "good cause" for why that privilege should apply. The factors to be considered included the number of shareholders, the *bona fides* of the shareholders bringing the suit, whether their claim was colorable, the importance to the shareholders obtaining those records, the nature of the accused conduct, the nature of the attorney–client communications, the specificity of the requests for attorney–client communications, the risk of revealing trade secrets or other confidential information, and any other factors appropriate to consider.

Not all jurisdictions have adopted the *Garner* "good faith" test for whether attorney–client communications are discoverable in a derivative lawsuit. Some courts have expressed concern over the uncertainty that such a test can create, and the chilling effect that this uncertainty could have on directors' and officers' willingness to seek advice of corporate counsel on important governance issue. One of these courts is the Supreme Court of Pennsylvania, which recently took a thorough look at the merits of the *Garner* good cause analysis, weighed them against the drawbacks of what the Court refers to as "the most revered" form of privilege, that between an attorney and client, and rejected the *Garner* test as too detrimental to the need for certainty in applying the privilege.

Initially, the Pennsylvania Supreme Court recognized "the conceptual difficulties of the attorney–client privilege in derivative litigation where both sides professed to represent the corporation, which is the true client and holder of the privilege but cannot act on its own. Nonetheless, it began its analysis by recognizing the United States Supreme Court's decision in *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343, 348-49 (1985) in which the Supreme Court found that current management of a solvent corporation is deemed to have the authority to act on behalf of the corporation, including in regard to the attorney–client privilege. The Pennsylvania Supreme Court also acknowledged, however, that Pennsylvania has a stronger attorney–client privilege than the privilege recognized in those jurisdictions that use a [*Garner*] balancing approach."

As a result, despite the Court's precedent disfavoring evidentiary privileges which are in tension with the truth determining process of the justice system, the Pennsylvania Supreme Court found that the importance of certainty in the application of attorney–client privilege was too important to be overruled by the factors cited by the Fifth Circuit in *Garner*. Citing *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981), the Pennsylvania Supreme Court found that "[a]n uncertain privilege, or one which purports to be certain but results in widely varying applications by the Courts, is little better than no privilege at all."

As such, the Pennsylvania Supreme Court concluded that the *Garner* good cause analysis is inconsistent with the attorney–client privilege under Pennsylvania jurisprudence because it eliminates the necessary predictability of privilege. In reaching this conclusion, Pennsylvania joins other juris-

dictions which have elected to preserve the strength of their attorney–client privilege laws over the desire of derivative plaintiffs to seek access to attorney–client communications.

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Featured Article

# Challenges to Defending Form U5 Expungement Claims

**By Jessica E. Levine**

Within 30 days of terminating an associated person's registration, FINRA member firms are required to file a Uniform Termination Notice for Securities Industry Registration, commonly called a Form U5. The member firm must disclose on the Form U5 whether the registered representative's separation from the firm was voluntary, a permitted resignation or a termination. If the member firm discloses that the individual was "permitted to resign," "discharged" or "other," it is required to explain the circumstances surrounding the separation. Towards this end, pursuant to FINRA NTM 10-39, this explanation must provide sufficient detail such that "a reasonable person may understand the circumstances that triggered the affirmative response." These termination explanations become part of the associated person's Central Registration Depository ("CRD") record, which future employers and the public (through FINRA's BrokerCheck) have access to and frequently rely on.

To the extent registered representatives believe that the information on their Form U5 is inaccurate, the only option for them to amend the Form is to initiate an expungement proceeding against their former firm. Accordingly, despite member firms' efforts to provide accurate disclosure information on Form U5s, increasingly companies have found themselves vulnerable to legal claims from former registered representatives who do not agree with the company's stated reason for their termination. Further, registered representatives will frequently file arbitrations not only seeking expungement, but also seeking monetary damages for defamation claims and/or wrongful termination claims. As a result, these arbitrations often pose a threat for potentially large damage awards and high defense costs.

The FINRA rules that typically govern expungements in customer cases (*i.e.*, Rule 2080, 2081, 12805 and 13805) do not apply to intra-industry U5 expungement claims, unless the information to be expunged also involves customer dispute information. In intra-industry disputes, FINRA can only expunge U5 information to the extent it is directed to do so by an arbitration award and provided with language to replace the original disclosure. If arbitrators recommend expungement of non-customer dispute information and determine that the original disclosure language is defamatory in nature, FINRA may expunge the information *without* a court order. However, to the extent an award does *not* include a finding of defamation, FINRA will expunge the information only if the arbitration award is confirmed by a court of competent jurisdiction.

Given that defamation is often a central issue in U5 expungement claims, it is important to consider that certain states (*e.g.*, California and New York) have held that statements on U5s are protected by an absolute privilege, whereas other states, including Connecticut and Florida, have applied a qualified privilege standard. (An absolute privilege immunizes member firms from defamation claims, whereas a qualified privilege recognizes that member firms have some obligation to make U5 disclosures, while allowing recovery for defamation if the associated person can establish that the firm acted intentionally, recklessly or with malice, depending on the state.) However, given that FINRA is an equitable forum, arbitrators generally focus on whether the U5 disclosures are inaccurate or false, not whether the registered representative can satisfy each legal element of a defamation claim.

In light of FINRA's specific procedural requirements, U5 expungement claims can be challenging to resolve in advance of a hearing. To the extent member firms want

to resolve these cases, there are typically two options: (1) settle the case and permit the registered representative to pursue an expungement hearing without the firm's participation or (2) settle the case and agree to a stipulated arbitration award with proposed disclosure language.

Settling in advance of an expungement hearing is often the easier course of action for member firms. This strategy places the burden on the registered representative to prove that the original U5 disclosure was defamatory and to propose alternative disclosure language to the arbitration panel. However, given that member firms typically will not participate in the final expungement hearing, this resolution strategy will often result in the arbitration panel finding that the original U5 disclosure language was defamatory and issuing a publicly available arbitration award stating same.

In contrast, negotiating a stipulated arbitration award requires the parties to agree to proposed replacement disclosure language. This negotiation can be challenging, particularly in light of the member firm's obligation to provide complete and accurate information on the registered representative's U5. However, if the parties can agree to proposed alternative disclosure language, and the registered representative is willing to have the arbitration award confirmed by a court, this strategy allows member firms to avoid a ruling that the original U5 disclosure language was defamatory.

*Jessica E. Levine is a partner with Winget, Spadafora & Schwartzberg, LLP. Her practice focuses primarily on securities and financial services litigation. She also has successfully represented professional liability cases in federal and state courts. Ms. Levine is a 2004 graduate of Emory University, where she earned her B.A. in political science. She received her J.D. in 2007 from New York Law School, where she served on the executive board of the Moot Court Association. Ms. Levine is admitted to practice law in New York and New Jersey. She is also admitted to practice in the United States District Courts for the Southern and Eastern Districts of New York, and the District of New Jersey.*