

IBDC

How to Prevent Your Dispute From Turning From an Ant Hill Into a Mountain

Gilbert W. Boyce
Partner
Kutak Rock LLP

Christopher P. Parrington
Of Counsel
Kutak Rock LLP

Victoria H. Buter
Partner
Kutak Rock LLP

Introductions

- Presenters:
 - Gilbert W. Boyce — Washington D.C. Office
 - Christopher P. Parrington — Minneapolis Office
 - Victoria H. Buter — Omaha Office
- Kutak Rock LLP

Internal Investigations

Gilbert W. Boyce
Partner
Kutak Rock LLP

Initiating and Planning Internal Investigations

- Internal investigations generally should be initiated under the following circumstances:
 - Civil suits / arbitrations
 - Whistleblower
 - Government / regulatory subpoena (to you or others similarly situated)
 - Regulatory investigation
 - Customer complaint

Initiating and Planning Internal Investigations, cont'd

- Must determine if the problem is local, domestic or international
- Must determine if there are criminal implications
- If there is a parallel government / regulatory investigation, planning considerations are different
- Must have a plan or protocol to handle employees who fail to cooperate
- Must preserve documents and evidence

The Right Person(s) Must Conduct the Investigation

- Ideally, internal investigations should be conducted and, at a minimum, supervised by experienced counsel
- In-house counsel vs. outside counsel (which outside counsel)
- Compliance officers / managers under the supervision of counsel

The Right Person(s) Must Conduct the Investigation,

cont'd

- Who should not conduct the internal investigation:
 - Managers / supervisors
 - Employees
 - Anyone with a potential conflict of interest

The Right Person(s) Must Conduct the Investigation, cont'd

- Other professionals (non-lawyers) can conduct / participate in the investigation (CPAs, private investigators, computer forensic specialists) if they are retained by counsel
 - Which professional? Should not use anyone who may be a fact witness

Upjohn Warnings and Proper Planning for Employee Interviews

- If conducted by counsel, he / she must warn employees at a minimum:
 - You represent the company, not the employee / witness
 - They have a right to counsel
 - The privilege belongs to the company and it may or may not waive it
 - False statements may result in criminal prosecution
 - They should maintain the confidentiality of the interview

Upjohn Warnings and Proper Planning for Employee Interviews, cont'd

- Should not advise employee on whether he / she needs a lawyer
 - Make sure you are aware of the company's policies and bylaws (HR)
- Must analyze / consider where to conduct the interviews
- Avoid common missteps when conducting employee interviews
- Must determine how you are going to document the internal investigation and whether to prepare a report

You Must Analyze and Address Potential Conflicts of Interest

- When company counsel also represents employees, there is an omnipresent potential for conflicts of interest, especially where the company cooperates with a government or regulatory investigation or intends to do so

You Must Analyze and Address Potential Conflicts of Interest, cont'd

- Obtain a written conflict letter / waiver (not every conflict is waivable)
 - OTRs
 - Arbitrations
 - Subpoenas
 - IRS summons

You Must Analyze and Address Potential Conflicts of Interest, cont'd

- Counsel must promptly withdraw from representation when it is clear there is a conflict
- The firm and counsel must preserve privileged communications / information occurring prior to withdrawal from representation
- If it is determined that an employee needs separate counsel, careful consideration should be given as to whether the company should suggest counsel and / or pay their fees
- Regulators are becoming more focused on conflicts of interest

Protecting Information From Discovery: Waiver of the Attorney-Client Privilege or Work Product Doctrine

- Failure to properly create a Kovel privilege for consultants, agents and experts
- Producing documents to the government / regulators
- Producing documents to a party in civil litigation or arbitration
- If privileged documents are voluntarily produced to the government or regulators, try to obtain a confidentiality or non-waiver agreement between the government and the company

Protecting Information From Discovery: Waiver of the Attorney-Client Privilege or Work Product Doctrine, cont'd

- Do not require employees to sign or adopt an interview memorandum
- Do not allow other individuals to be present during interviews (family, spouse, significant other, priest, friends, etc.)
- Every document generated by the investigation team should have a legend clearly indicating that it is subject to the attorney-client privilege and / or work product doctrine
- Do not allow the employee / interviewee to take notes during the interview
- No verbatim recording of the employee / witness interviews

Filing a Claim With Your Insurance Carrier

Christopher P. Parrington
Of Counsel
Kutak Rock LLP

Understanding Different Types of Insurance

- Errors and Omissions
 - Also referred to as Professional Liability Insurance
 - Typically covers professional negligence, breach of duty claims, claims involving incorrect advice and mistakes
 - Typically does not cover fraud claims (the “F-Word”)
 - Typically has exemptions based upon types of conduct, types of investment products and claims pertaining to certain individuals

Understanding Different Types of Insurance, cont'd

- Directors and Officers
 - Covers claims made against managers regarding alleged wrongdoing in their official duties
 - Often purchased by broker / dealers as additional insurance along with E&O
 - Typically does not cover fraud claims (the “F-Word”)
 - Typically contain shrinking policy limits
 - Coverage on a claims-made basis
 - May cover claims not covered by E&O insurance such as criminal or regulatory actions

Understanding Different Types of Insurance, cont'd

- Fidelity Bond
 - Form of insurance to protect against fraudulent or dishonest actions by certain individuals
- Cyber and Privacy Insurance
 - Covers a businesses liability for data breach impacting customers' personal information

Who Should File a Claim With Your Insurance Carrier?

- Internal personnel
- Outside legal counsel
 - Coverage counsel vs. defense counsel considerations
- Insurance agent / broker

How to File a Claim With Your Insurance Carrier

- When should a claim be filed?
 - Understand the policy's claim reporting requirements
- Does the carrier have a claim form?

How to File a Claim With Your Insurance Carrier, cont'd

- What information should be included?
 - Facts vs. opinions
 - Relevant documents
 - Internal investigation materials and results
 - What is discoverable?

How to File a Claim With Your Insurance Carrier, cont'd

- Understand the scope of coverage
 - Claim period
 - Exemptions
- Do not conceal information from the carrier

Working With Your Insurance Carrier During the Claim Process

- Initial reports and recommendations
- Key updates throughout the dispute
 - Discovery strategies
 - Motions
 - Mediation / settlement conferences
 - Newly discovered facts or concerns

Working With Your Insurance Carrier During the Claim Process, cont'd

- Pre-arbitration report and recommendation
- Arbitration strategies
 - Expert witnesses
 - Arbitrator selection
 - Defense strategies

Defending Yourself in Lawsuits

Victoria H. Buter
Partner
Kutak Rock LLP

You Have Been Sued – Now What?

- Arbitration or Litigation?
 - Is the claimant really a customer?
 - How old is the claim?
 - Location of the claim / forum?
 - Injunctions to stay litigation or arbitration vs. motions to dismiss

Arbitration and Disadvantages of Arbitration

- Confidentiality
 - Greater confidentiality in FINRA Arbitration
- Discovery
 - Limited in FINRA arbitration
 - Rarely deposition practice

Arbitration and Disadvantages of Arbitration, cont'd

- Dispositive Motion Practice
- Available defenses
- Reasoned opinions
- Appeal rights

Defending Yourself in Arbitration

- Conducting discovery during arbitration
 - Requests for documents and information
 - Third-party subpoenas
 - Informal discovery

Defending Yourself in Arbitration, cont'd

- Expert witnesses
 - Pre-hearing assistance
 - Attendance at hearing and presentation
- Presenting evidence at the arbitration hearing

Defending Yourself in Arbitration, cont'd

- Defense cost consideration
 - Retentions
 - Policy limits
 - Other potential claims
 - What are the products and who else bought them?
 - Who was the registered representative and what other business did he / she have?
 - Who is claimant's counsel and what is his or her reputation?

Potential Regulatory Issues

Christopher P. Parrington
Of Counsel
Kutak Rock LLP

How Do Claims Turn Into Regulatory Investigations?

- Chicken or the egg scenario
- FINRA Rule 12104 (customer disputes):
 - Subd. (b) – arbitrator may refer matter to Director if the arbitrator “has reason to believe [the matter or conduct] poses a serious threat, whether ongoing or imminent, that is likely to harm investors unless immediate action is taken.”

FINRA Rule 12104 (customer disputes)

- Subd. (e) – after arbitration, arbitrator may refer to FINRA for investigation if has reason to believe any matter or conduct may constitute a violation of the rules of FINRA, federal securities laws or other rules or laws

FINRA Rule 13104 (industry disputes)

- Subd. (b) – similar to Rule 12104(b)
- Subd. (e) – similar to Rule 12104(e)

Arbitration Standards vs. Regulatory Standards

- Arbitrations
 - FINRA Rule 12410 – panel rulings and determinations must be made by a majority of the arbitrators.
 - FINRA Dispute Resolution Arbitrator’s Guide:
 - “Arbitrators are not strictly bound by legal precedent or statutory law.”
 - Arbitrators should not “manifestly disregard the law.”
 - Typical for panels to decide based upon what is “fair and equitable” to the parties.

Arbitration Standards vs. Regulatory Standards, cont'd

- Arbitrations
 - Arbitration awards are monetary and / or injunctive relief.
 - Arbitration awards typically do not include explained decisions unless requested per FINRA Rule 12904.

Arbitration Standards vs. Regulatory Standards, cont'd

- Regulatory
 - Investigations
 - FINRA Rule 8201 – requires production of documents, information and testimony on “any matter involved in the investigation, complaint, examination or proceeding.”
 - Sufficiency of Evidence review following investigation. (See NTM 09-17).
 - Is there a violation of FINRA Rules or securities laws?
 - What is the nature and severity of the violation?
 - Is there customer harm?

Arbitration Standards vs. Regulatory Standards, cont'd

- Investigations
 - Sufficiency of Evidence review following investigation. (See NTM 09-17).
 - Is there a violation of FINRA Rules or securities laws?
 - What is the nature and severity of the violation?
 - Is there customer harm?

Arbitration Standards vs. Regulatory Standards, cont'd

- Investigations
- Wells Process:
 - Discretionary per FINRA enforcement staff.
- Enforcement Actions:
 - Decided by a hearing officer and two industry panelists.
 - Were there violations of FINRA Rules or securities laws?
 - Enforcement actions can result in sanctions and suspensions.

Examples of Claims Out of Control

- Example #1
 - Registered rep leaves firm and names supervisor in industry dispute arbitration over unpaid commissions.
 - Supervisor files counterclaim alleging Reg S-P violations related to manner in which rep departed.
 - Client retained non-securities counsel who advised rep to take files for “her customers” when leaving the firm.
 - Customers were all participants in 403(b) plans handled by the rep.
 - No independent insurance for rep.

Examples of Claims Out of Control, cont'd

- Panel awarded commissions to rep and dismissed supervisor's counterclaim.
- Panel refers matter to FINRA per Rule 13104(e) for investigation into rep's departure from firm.
- FINRA pre-Wells call alleges more than 4,000 separate Reg S-P violations by rep (calls it one of biggest Reg S-P violations in district history).
- FINRA demands 10-year suspension and \$100,000 sanctions.

Examples of Claims Out of Control, cont'd

- Example #2
 - Non-industry member gets investor complaints related to investments made over 10 years, including state court lawsuits.
 - Immediately files claim on D&O policy and retains legal counsel.
 - Defendant wants to resolve on his own through direct communications with investors (family and friends).

Examples of Claims Out of Control, cont'd

- SEC initiates investigation into fundraising activities.
- SEC matter resolved following investigation and attorneys' proffer.
 - SEC represents that matter not being referred to Department of Justice.
- 48 hours later, Defendant is arrested for violating state securities laws including Ponzi scheme allegations.
 - Allegations include \$10 million in customer losses and seeks 25-year sentence.

Examples of Claims Out of Control, cont'd

- Client files bankruptcy and investors file multiple adversary complaints.
- Through coordination of legal counsel and D&O carrier, final results:
 - No contest plea to negligent sale of unregistered securities under state law – no jail time.
 - SEC sanctions offset by restitution payments in criminal case.
 - State court actions settled through insurance proceeds.
 - 1/5 of restitution payments satisfied through settlements with insurance proceeds.
 - Order of Discharge in bankruptcy proceedings.

Conclusions

Three key takeaways:

1. Know your business and its insurance needs, and have adequate insurance.
2. Be proactive in responding to a claim (customer or other industry member).
3. Be mindful of ALL potential consequences (other claims and regulatory issues).

Questions

Gilbert W. Boyce

- Gilbert.Boyce@KutakRock.com
- (202) 828-2427

Christopher P. Parrington

- Christopher.Parrington@KutakRock.com
- (612) 334-5000

Vicki H. Buter

- Vicki.Buter@KutakRock.com
- (402) 231-8875

IBDC