THOMPSON HINE

Business Law Update

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Mergers & Acquisitions

The Common-Interest Doctrine: Preserving the Attorney-Client Privilege in M&A Deals

By Mark R. Butscha, Jr. and Michael W. Jahnke

Several years after acquiring Company X, your company is sued based on successor liability for alleged fraudulent activity committed by Company X prior to the acquisition. During discovery, the plaintiff seeks disclosure of communications between your company and Company X during merger discussions, including analyses shared between both parties' attorneys of the facts now alleged to underlie the fraud claims. Revealing otherwise privileged communications to a third party generally destroys the attorney-client privilege. However, the common interest doctrine, aka the joint defense privilege, is an exception to that general rule which could shield information shared during due diligence—a necessary commercial and legal reality—from disclosure. Your company rebuffs the plaintiff's discovery request, invoking the common-interest doctrine and withholding the communications as privileged. The plaintiff moves to compel disclosure. Might the court order disclosure of those communications?

That is precisely what happened in a recent New York case. In *Ambac Assurance Corp. v. Countrywide Home Loans, Inc.*, Countrywide had merged with Bank of America, and Bank of America was sued based on alleged fraud by Countrywide prior to the merger. During discovery, Bank of America withheld hundreds of communications with Countrywide between the signing of the merger agreement and closing, and it "listed the communications on a privilege log and claimed they were protected from disclosure by the attorney-client privilege because they pertained to a number of legal issues the two companies needed to resolve jointly in anticipation of the merger closing, such as filing disclosures, securing regulatory approvals, reviewing contractual obligations to third parties, maintaining employee benefit plans and obtaining legal advice on state and federal tax consequences."

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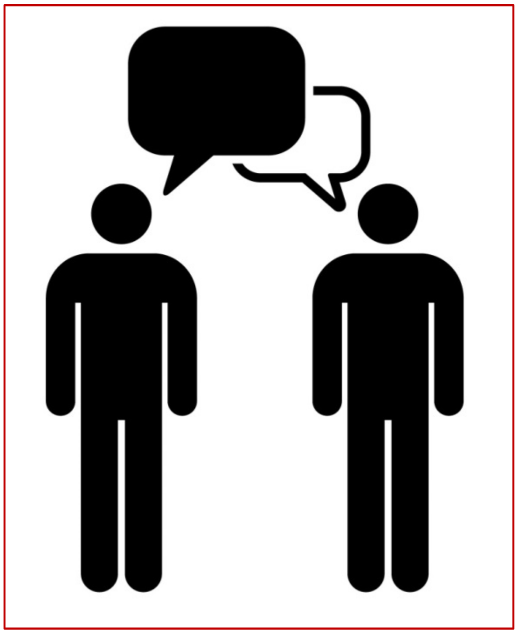
For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.



Bank of America argued that the common-interest doctrine shielded the communications from disclosure, but the trial court disagreed and ordered disclosure. The New York Court of Appeals agreed with the trial court, holding that, under New York law, shared communications must "be in furtherance of a common legal interest in *pending or reasonably anticipated litigation* in order to remain privileged from disclosure." Accordingly, communications shared in furtherance of a common legal interest during merger discussions are not privileged.

The *Ambac Assurance* decision has serious implications for the common, and necessary, practice of sharing information by parties to a deal. The dissenting opinion recognized this and would have dispensed with the "reasonably anticipated litigation" requirement because extending "the attorney-client privilege to these communications is fully in line with the goals of our common law and the needs of our complex system of commercial regulation." The majority of federal courts to have considered this issue agree with that sentiment and uphold the privilege, as do some states. For example, Delaware law protects communications made "to a lawyer or a representative of a lawyer representing another in a matter of common interest," regardless of whether litigation is pending or imminent. This provision is broad enough to encompass communications between two merging parties concerning issues of shared legal interest, such as regulatory compliance. Nonetheless, the communications still must be made when the parties' interests align (i.e., after merger discussions commence), and purely business communications are not protected—the common-interest doctrine is not an independent source of privilege.

The patchwork of state and federal laws governing this issue make predictability difficult, and the *Ambac Assurance* decision may present more questions than answers. For example, what constitutes "reasonably anticipated litigation"? Also, for cases brought in federal court where "state law governs privilege regarding a claim or defense for which state law supplies the rule of decision," what privilege applies if both state and federal claims are made? Despite this uncertainty, there are some best practices parties should follow to increase their chances of preserving the attorney-client privilege. Parties should execute a joint defense agreement that identifies the parties' shared legal interest and includes a choice-of-law clause electing a state with the broadest protections possible. Parties should also mark communications as subject to a joint defense arrangement (e.g., "Privileged and Confidential Joint Defense Materials") and consider restricting access to certain information to essential people. At minimum, parties should consult with counsel concerning sensitive communications and the most effective means of navigating the sometimes choppy waters of the common-interest doctrine.

With any questions, please contact Mark Butscha or Michael Jahnke.

General Corporate

Operating as a Public Benefit Corporation: Pros & Cons

By Jim Brown and Tony Kuhel

Thirty states and the District of Columbia have enacted public benefit corporation legislation. A "public benefit corporation" is a legal entity permitting board members and management of a company to consider certain social benefits, values or constituencies, rather than solely focusing on shareholder value, when making decisions regarding the company. In 2010, Maryland became the first state to pass public benefit corporation legislation and there are now an estimated 4,000 public benefit corporations in the United States.

Public benefit corporations are not to be confused with certified B corporations (B corps). A public benefit corporation is a distinct legal entity and a creation of state statute, while a certified B corporation is a company certified as such by B Lab, a nonprofit organization that establishes certain standards regarding a company's social and environmental impact and transparency and accountability. B corp certification provides an indication of a company's commitment to promoting a public benefit of some kind, but does not necessarily confirm that a company is a public benefit corporation under state law.

While state law dictates that the board of a traditional corporation act to maximize shareholder value, public benefit corporation statutes require company boards to balance certain public benefits, or consider other constituencies, in addition to the company's shareholders. Some statutes provide that a company may adopt a general public purpose, often described as one that has a material, positive impact, or one that reduces negative effects, on society or the environment, as assessed against a third-party standard, while other states require a company to adopt a more specific beneficial purpose. This flexibility permits a company to operate in a way that is consistent with its stated purpose without being concerned that pursuing its goals is somehow inconsistent with the traditional corporate purpose of maximizing shareholder value.

There are many potential benefits to operating as a public benefit corporation. The very nature of a public benefit corporation provides flexibility from a corporate governance perspective. Statutes require directors to balance the stated public benefit of the company with shareholder return. This permits the board considerable discretion in managing the company, assuming that the required constituencies or values are taken into account in reaching decisions. Further, the public benefit corporation form allows a company to raise outside capital to support its mission, even if the invested capital is deployed in a manner that does not maximize its return on invested capital from a purely financial perspective. Some companies have been able to use their status as public benefit corporations to attract capital as "impact investments," which are preferred by a segment of the investment community that is generally focused on socially responsible ventures. Public benefit corporations can do more than just tell impact investors they prioritize societal benefits; they can show they have a corporate mandate to do so. This commitment can also be useful for branding purposes as it shows a company is willing to undergo a lawful obligation to achieve its chosen social benefit, going far beyond a catchy slogan or lofty advertisement.

There are, however, potential pitfalls to operating as a public benefit corporation. The public benefit corporation is a relatively new statutory creation, so there is limited legal precedent to provide guidance on exactly how public benefit corporations may be managed. Uncertainty may cause hesitancy on the part of boards that could impede the operation or growth of the company. In addition, while some investors may actively seek a venture committed to serving a public benefit, other investors may be wary of a company that is responsible to a constituency other than its shareholders. Lastly, public benefit corporation legislation often requires special reporting by the company to demonstrate adherence to its stated purpose, which can be burdensome for small companies already strapped for resources.

The growing popularity of public benefit corporations shows they have gained a place within the corporate statute paradigm. With seven states currently considering public benefit corporation legislation, nearly 40 states may have such acts in the near future. Though certainly not appropriate for every venture, the public benefit corporation grants companies the flexibility to consciously pursue activities beyond the traditional goal of maximizing return to shareholders.

With any questions, please contact Jim Brown or Tony Kuhel.

Decreasing the Exercise Price of a Statutory Stock Option

By Sean Ganley and Kent L. Mann

Clients often inquire about the ability to decrease the exercise price of a statutory option (i.e., an option granted under an incentive stock option plan or an employee stock purchase plan) after a decline in the value of their company. In many of those cases, the option is "underwater" – the exercise price is greater than the current fair market value of the underlying shares – thereby negating any incentives the company intended when the option was originally awarded. With the adoption of certain Treasury Regulations permitting the repricing of statutory options without disqualification in certain situations, decreasing the exercise price is possible. With that said, before attempting to modify the exercise price, the following points should be carefully considered.

Modification of an Option

First and foremost, it is essential to understand that any "modification" (or extension or renewal) of the terms of an option is considered the granting of a new option in the eyes of the United States Internal Revenue Service (IRS). Therefore, if a change to the terms of an option is considered a "modification," technically, the old option will be replaced by a new option, subject to a new holding period and new exercise price requirement.

But is a downward adjustment to the exercise price of an option considered a "modification" by the IRS? According to Treasury Regulations Section 1.424-1(e)(4)(i), a modification occurs if there is any change in the terms of an option that gives the optionee additional benefits under the option, regardless of whether the optionee in fact benefits from the change in terms. So, by way of example, a change to the terms of an option that shortens the exercise period would not constitute a "modification," as the change does not provide an additional benefit to the optionee (i.e., the change is actually to the detriment of the optionee). In all cases, though, a change to the terms of an option that decreases the exercise price of the option provides an additional benefit to the optionee and, as a result, will be considered a modification.

The above notwithstanding, just because a potential modification is offered to an optionee does not mean that a modification occurs. According to Treasury Regulations Section 1.424-1(e)(4)(iii), an option "is not modified merely because an optionee is offered a change in the terms of an option if the change to the option is not made." So, for example, if a company offers an optionee the opportunity to decrease the exercise price, but such optionee declines the offer and the change to the option is not made, there will be no "modification" to the option. However, this only applies to an offer to change the terms of an option that remains open for less than 30 days. If an offer to change the terms of an option remains outstanding for 30 days or more, there is a modification of the option as of the date the offer to change the option is made, regardless of whether the offer was ultimately accepted. So, for companies that are giving optionees the choice to lower the exercise price of their options, make sure such offer is only open for less than 30 days, otherwise all options subject to the offer will be considered modified, even if the offer is refused.

Consequences of Modification

Besides subjecting the option to a new holding period, another consequence to consider is the fact that a statutory option may, as a result of a modification, cease to be a statutory option going forward (on the other side of the coin, a non-statutory option can also become a statutory option).

One way an option can lose its statutory status is if the modified exercise price strays from the deemed fair market value of the option at the time of modification. For incentive stock options, in order to remain a statutory option, the option price per share must remain at least equal to the fair market value of the share at the time of modification.

For stock purchased pursuant to a Section 423 employee stock purchase plan, the option price per share must remain within 85 percent of the fair market value of the share at the time of modification. To calculate the fair market value in connection with a Section 423 employee stock purchase plan, the highest of the following values shall be considered to be the fair market value of the stock at the time of modification:

i. the fair market value on the date of the original granting of the option;

ii. the fair market value on the date of the making of such modification; or

iii. the fair market value at the time of the making of any intervening modification (see Treasury Regulations Section 1.424-1(e)(3)).

In situations where market decline has caused stock options to become underwater, companies may wish to (carefully) consider option repricing in order to restore the incentive, motivational and retentive benefits the stock options were originally intended to provide.

Again, if the new exercise price and the deemed fair market value of the underlying stock are now at such a distance that the exercise price is no longer within 85 percent of the fair market value, an option granted under an employee stock purchase plan that was previously treated as a statutory option would cease to be one.

Finally, and similar to the above, the application of Section 409A can also be triggered by a modification, including modification of a non-statutory option. Section 409A will apply to a decrease in the exercise price of an option to the extent the new exercise price is below the fair market value as of the date of modification.

Conclusion

If the exercise price of a statutory option is to be decreased, the documentation should consist of a communication to the current optionholders (in the form of a letter, notice or memorandum) that gives each optionholder the right to elect the lower exercise price (but only for a period of less than 30 days). In addition, board approval will be required to modify the option. Ultimately, decreasing the exercise price of a stock option might be in the interests of the company and its optionholders. Strong consideration, though, should be given to the above to avoid any unintended consequences of an option modification.

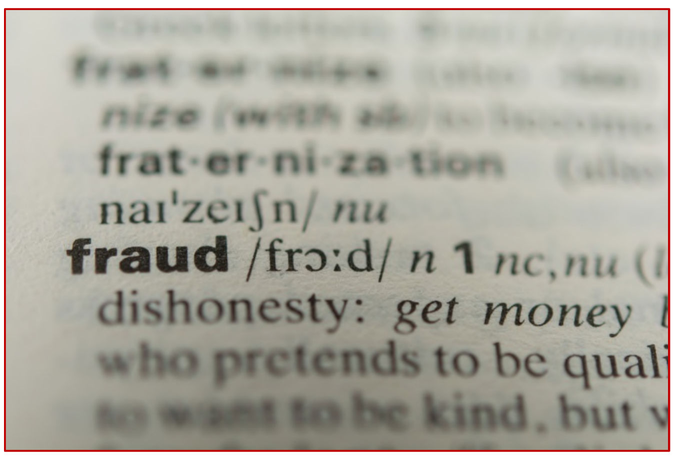
With any questions, please contact Sean Ganley or Kent Mann.

Corporate Governance

Imputing the Fraudulent Intent of One Director to the Corporation

By Jennifer L. Maffett-Nickelman

Can one bad director spoil the board? The United States District Court for the Southern District of New York said yes, when Judge Cote held that the fraudulent intent of one director can be imputed to the corporation and is sufficient to plead an actual fraudulent transfer claim. In *Weisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635, 648 (S.D.N.Y. 2016), the trustee of a litigation trust created as part of bankruptcy debtor Lyondell's chapter 11 plan alleged fraudulent transfer claims against the former shareholders of Lyondell based on their receipt of proceeds from the leveraged buyout (LBO) that took place just over a year before Lyondell filed bankruptcy.



Prior to the LBO, Lyondell's board consisted of Dan Smith, who was the CEO and chairman of the board, and ten outside directors, all of whom were shareholders. In the summer of 2007, a buyer approached Lyondell with an offer to purchase the company in an LBO transaction. Smith allegedly prepared and presented fraudulent financial projections to the buyer and its lenders showing inflated earnings before interest, tax, depreciation and amortization (EBIDTA). The buyer relied on these alleged false projections and increased its offer substantially. Smith hurried the deal through, with the trustee alleging the ultra-quick timeline was to prevent the buyer and its lenders from completing appropriate due diligence. The board unanimously approved the transaction, which was financed 100 percent by debt secured by Lyondell's assets. The outside directors received over $19 million and Smith received over $100 million as a result of the LBO. Within weeks after the transaction closed, Lyondell was experiencing significant liquidity issues, and one year later Lyondell filed chapter 11 bankruptcy.

The Bankruptcy Court had previously dismissed the litigation trustee's constructive fraudulent transfer claims based on the safe harbor provisions of Section 546(e) of the Bankruptcy Code that excepts certain securities transactions from constructive fraudulent transfer claims. However, actual fraudulent transfer claims do not fall within that exception, so that claim remained subject to the shareholders' motion to dismiss.

The Bankruptcy Court dismissed the actual fraudulent transfer claim, finding that the alleged fraudulent conduct of one or two officers/directors was not sufficient to impute fraudulent intent to the company (the actual transferor of the assets) when those individuals alone could not approve the transaction and there was no allegation that they somehow controlled the 11-person board that had the ultimate authority to approve it.

The District Court reversed, holding that under Delaware law, the imputation doctrine provides that the "knowledge and actions of the corporate officers and directors, acting within the scope of their authority, are imputed to the corporation." The court explained that a corporation can only act through its agents, and a corporation is held liable for the knowledge and actions of its agents even when an agent acts fraudulently or illegally. The court stated that this position is consistent with other state laws and incentivizes companies to have effective systems in place governing the handling and reporting of company information. Because Smith's preparation and presentation of the alleged false financial projections were within the scope of his employment, his alleged fraudulent intent can be imputed to the company.

The District Court rejected the shareholders' argument that the existence of a "functioning board" somehow altered the imputation doctrine, finding that such argument had no basis in Delaware law. It also rejected the argument that because Smith alone could not have approved the transaction, because Delaware law requires the entire board to approve an LBO, his intent alone was insufficient to impute a fraudulent intent to the company. Again the court held there was no basis in Delaware law for such an exception to established agency principles.

The District Court recently denied the shareholders' request that it reconsider its ruling denying the motion to dismiss, so the case will proceed. However, even the court noted some of the obstacles the litigation trustee must overcome to be successful in its actual fraudulent transfer claim. At the motion to dismiss stage, the allegations in the complaint are presumed true, so the litigation trustee still has the significant burden to prove the alleged facts. The court also cited the adverse interest doctrine, which is that the intent of an agent may not be imputed to the principal if the agent was "acting solely to advance his own personal financial interest, rather than that of the corporation itself," but noted that the parties had not relied on this exception at the motion to dismiss stage. While the litigation trustee still has a long road ahead to actually claw back the billions paid to the shareholders in the LBO, this case should serve as a warning to corporate boards to review their processes for negotiating, reviewing and approving significant transactions, particularly ones from which any officer or director stands to benefit personally.

Please contact Jennifer Maffett-Nickelman with any questions.

Thompson Hine Earns First-Tier Rankings in "Best Law Firms"

Thompson Hine LLP has repeated its top-tier placement in the *U.S. News-Best Lawyers®* 2017 "Best Law Firms" rankings, earning national and regional recognition. Firms included on the "Best Law Firms" list are recognized for professional excellence with consistently impressive ratings from clients and peers. Achieving a tiered ranking signals a unique combination of quality law practice and breadth of legal expertise.

Thompson Hine received 129 rankings, including eight national first-tier rankings and metropolitan rankings for Atlanta, Cincinnati, Cleveland, Columbus, Dayton, New York and Washington, D.C., in the following areas:

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- Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law*
- Closely Held Companies and Family Businesses Law
- Commercial Litigation*
- Construction Law*
- Corporate Law*
- Criminal Defense: White-Collar
- Employee Benefits (ERISA) Law
- Employment Law – Management
- Environmental Law
- Financial Services Regulation Law
- Health Care Law
- Insurance Law
- Labor Law – Management
- Litigation – Antitrust
- Litigation – Banking & Finance
- Litigation – Bankruptcy
- Litigation – Construction
- Litigation – Environmental
- Litigation – ERISA
- Litigation – Mergers & Acquisitions
- Litigation – Patent
- Litigation – Real Estate
- Litigation – Securities
- Litigation – Tax
- Mass Tort Litigation/Class Actions – Defendants*
- Mergers & Acquisitions Law
- Patent Law
- Product Liability Litigation – Defendants
- Real Estate Law*
- Securities/Capital Markets Law
- Tax Law
- Trademark Law
- Transportation Law*
- Trusts & Estates Law
- Venture Capital Law*

*National ranking

International

New Rules to Further Relax China's Foreign Investment Registration Requirements

By Pingshan Li and Will Lu

On September 3, 2016, the Standing Committee of the National People's Congress of the People's Republic of China (PRC) adopted the *Decision to Amend the Four Laws Governing Foreign-Invested Enterprises* (Decision). The four laws include *The Law on Foreign-Invested Enterprises*, *The Law on Sino-Foreign Equity Joint Venture Enterprises*, *The Law on Sino-Foreign Cooperative Joint Venture Enterprises* and *The Law on the Protection of Investments by Taiwan Compatriots* (collectively, FIE Laws). The Decision represents a legislative step to further lessen the regulation of foreign direct investments in China. Following the adoption of the Decision, on September 30, the State Administration for Industry & Commerce (SAIC) issued the *Notice on Implementing Foreign-Invested Enterprises Registration Filing Requirements* (SAIC Notice). On October 8, the Ministry of Commerce (MOFCOM) issued the *Interim Administrative Measures on Record-Filing of Foreign-Invested Enterprises' Establishment and Amendment* (collectively, Record-Filing Measures) to replace the old rules with regard to the approval requirements for the establishment and amendment to registration of foreign-invested enterprises (FIEs) in China. The following is a summary of what is anticipated to change – and remain unchanged – under these new laws, rules and measures.

To clarify, FIEs include not only foreign-invested enterprises, but also Sino-foreign equity joint venture enterprises, Sino-foreign cooperative joint venture enterprises and enterprises invested by Hong Kong, Macau and/or Taiwan investors.

One Change to China's Major Market Entry Control Regimes

No Changes for Those in Restricted or Prohibited Industries

MOFCOM and the National Development and Reform Commission promulgate the Foreign Investment Industry Guidance Catalogue (Catalogue) with regular updates; the most recent was published in 2015. Pursuant to the Catalogue, which is also the focal policy statement of China's market entry control, foreign investments into China are generally divided into four categories: (i) encouraged industries, (ii) permitted industries, (iii) restricted industries, and (iv) prohibited industries. As these names signify, the treatments of the four categories by the Chinese government are different in terms of the entry approval process.

According to the new Record-Filing Measures, which prescribe a simpler process compared with the previous regime, most investments in the encouraged or permitted industries pursuant to the Catalogue will be considered "Qualified Investments" that are eligible to follow the Record-Filing Measures and therefore enjoy a more straightforward process than before. It should be noted that pursuant to the Catalogue, certain encouraged or permitted industries have special requirements regarding controlling shareholders or senior management positions for policy reasons. In accordance with the Record-Filing Measures, investments in such industries would still be subject to the original "approval then registration" regime. For example, the industries involving commercial satellites, air transportation or power grids are encouraged industries but investments in these industries require Chinese controlling shareholders. Another example is accounting- or auditingrelated businesses, which require Chinese chief partners. Foreign investments in these businesses would still have to follow the previous approval process and the Record-Filing Measures would not apply.

The New Record-Filing Registration Regime

Under the prior regime, the establishment of an FIE must be approved by MOFCOM or its designated local counterpart first. The specific industry the investment is to be in and the total amount of investment are the most important factors that dictate whether another approving authority (for example, the environmental protection agency) would be involved. Only after receiving approval from MOFCOM or its designated local counterpart will the FIE then be allowed to register with SAIC and thus be legally established in China.

With the newly introduced regime, Qualified Investments will need to register in only one place: a national online filing system. In addition, this will be a "filing" process, not an approval process; the filing party will be required to file only an application form with supporting documents. The processing entity, generally a local counterpart of MOFCOM, will review the formality of the application but not its substance. It generally takes only three working days to process the filing and the filing results will be published on the online filing system.

It's important to note that certain "encouraged" or "permitted" industries have, for policy reasons, special requirements regarding controlling shareholders or senior management positions. In accordance with the new Record-Filing Measures, investments in such industries would still be subject to the original "approval then registration" regime.

Unlike the old approval-then-registration regime, where approval by MOFCOM is a prerequisite for the registration of an FIE with SAIC, in most instances under the new regime, the registration of an FIE can even proceed prior to the online MOFCOM record-filing as long as the FIE is a Qualified Investment.

For any investment that is not a Qualified Investment, the approval-then-registration regime remains unchanged.

Other Major Changes: From Approval-Based Regime to Record-Filing Regime

Simplified Application Process

In the old regime, the approving government authority was required to review the substance of the application documents and make a determination whether the proposed investment was in compliance with Chinese law and policy. The new record-filing system more closely resembles most business registration systems in the United States, where substantive review of the filing materials is not required. The new regime is supposed to be more streamlined and save money and time for foreign investors registering businesses in China. More importantly, the system will bring more certainty to the process of establishing FIEs in China.

Wider Application of Record-Filing System with Certain Exceptions

The new record-filing regime cannot be used in the following situations: (i) the proposed FIE is not a Qualified Investment; (ii) a foreign party proposes to acquire a domestic Chinese company that has no prior foreign shareholder or beneficial owner; and (iii) a foreign party proposes to acquire a publicly traded company in China. These types of application filings must still go through the original approval-then-registration regime.

More Disclosure and More Information Sharing

The Record-Filing Measures require the applicant to disclose its ultimate beneficial owner, which was not previously required. Under the original regime, only the State Administration of Foreign Exchange (SAFE) or its local counterpart would require an FIE to verify whether its beneficial owner includes PRC residents, and if not, no further information would be required. The new Record-Filing Measures seem to adopt a more stringent approach and require broader disclosure on beneficial ownership information.

Besides the new disclosure requirement, it is worth noting that MOFCOM is planning to share the record-filing information of an FIE with other government authorities, including SAIC, SAFE, China Securities Regulatory Commission, Public Safety Bureau, Tax Authority and Customs. The official reason for such information sharing is to create a credit system that will be based on the information collected by MOFCOM and the aforementioned other authorities in the course of record-filings, investigations or government audits.

Uncertainties

Negative List

It is widely believed that the Catalogue will be replaced by a national "negative list," which has been implemented on a trial basis in the China (Shanghai) Pilot Free Trade Zone since 2013, and was later expanded to the Guangdong, Tianjin and Fujian free trade zones in 2015. Only those proposed FIEs that are not in the industries on the national negative list would be able to use the new record-filing system. However, it is not clear when a nationwide negative list will be promulgated by the State Council. There are reports that the Chinese government is "negotiating" the national negative list with the U.S. government as it is one of the most controversial pending topics under the draft Bilateral Investment Treaty between China and the United States.

Although the exact scope of the national negative list remains unclear, it is expected to contain substantial changes from the Catalogue.

New Role of SAIC

When applying under the new record-filing system, pre-approval by MOFCOM for the registration of an FIE by the SAIC will no longer be required. The SAIC will be expected to play a heightened "gate-keeper" role in screening FIE registrations or amendments to such registrations. The SAIC has urged its local counterparts to switch to the "new tasks" and "new challenges" in conjunction with the new record-filing system. At this very initial stage of implementing the Record-Filing Measures, it remains to be seen how SAIC will tackle its new responsibilities.

The Big Picture

As practitioners of international business law involving China, we welcome the new developments because we believe they will streamline the processes for establishing FIEs in China. We believe it is part of a bigger trend as the Chinese government continues to reduce market entry restrictions on foreign investments. As we wait to see how these new rules and measures will be implemented, as well as what the final national negative list will look like, we are cautiously optimistic about the potential of this more open and welcoming business filing and registration system to benefit our clients.

With any questions, please contact Ping Li.

Will Lu, a PRC- and New York-licensed attorney, is visiting Thompson Hine from the DeHeng Law Offices in Shanghai, where he is a senior associate.

Litigation

Five Tips for Negotiating & Drafting Joint E-Discovery Plans

By Anthony J. Rospert and Jake Evans

The increasing prevalence of electronically stored information (ESI) is changing the civil litigation landscape with discovery costs now comprising a clear majority of the overall expenses. And these costs will only continue to increase as ESI grows exponentially. Developing effective measures to curb rising e-discovery costs is a paramount consideration in effectively managing a litigation budget.

One way to reduce costs is for the parties to agree on a joint e-discovery plan. Discussing, identifying and resolving potential ESI issues early in the matter can minimize discovery costs and maximize the likelihood that discovery proceeds promptly, achieving clients' goals and the aims of the Federal Rules of Civil Procedure. Indeed, Fed. R. Civ. P. 26(f)(3) requires parties to generate a discovery plan outlining "the parties' views and proposals on … any issues about disclosure, discovery, or preservation of electronically stored information, including the form or forms in which it should be produced." In complex and high-exposure cases where ESI discovery is significant, courts often require parties to develop a joint e-discovery plan. Even when they are not court-imposed, parties should consider using joint e-discovery plans to promote efficiency and transparency and streamline the discovery process.

This article surveys five best practices for negotiating and drafting joint e-discovery plans that can prove beneficial.

1. Storing and Preserving ESI Effectively

Storing ESI, particularly in third-party databases, can result in significant costs, which vary depending on the amount of data and the storage location. Locating and releasing responsive documents from a litigation hold can minimize these costs. The parties should lay out in the joint e-discovery plan what they are preserving and identify any additional ESI that should be preserved. All parties should ensure that the most relevant information and evidence needed to prove a claim or defense is being preserved, and that preservation obligations are not limitless, but based on the reasonable needs of the case.

There are multiple ways the parties can achieve cost savings relating to preservation, including:

- Agreeing on search terms to locate potentially responsive documents and release documents outside the search criteria — a so-called "catch and release."
- Stipulating to temporal limits on the duration that the data will be stored and subject to a litigation hold.
- Sharing the storage costs or indicating that the non-producing party will pay storage costs after a specified date.

The ideal arrangement is case-specific, but discussion and prospective planning formalized in a joint e-discovery plan can reduce costs and discovery disputes relating to the parties' preservation obligations.

2. Employing Technology-Assisted Review to Reduce Costs

Technology-assisted review (TAR) is defined as document review that is facilitated by the use of advanced analytics to help categorize the review population — either by conceptual analysis of the document content performed entirely by the software or "predictive" analysis and ranking performed by the software based on initial human input. In essence, TAR permits the parties to limit the documents subjected to human review by using computer-generated algorithms and streamlines responses to document requests. Its use has the benefit of identifying responsive information at a proportionate cost.

If determined to be cost-effective, it is advisable to stipulate to the use of TAR in the joint e-discovery plan. According to RAND Corporation research, human document review comprises 73 percent of e-discovery production costs. TAR limits ESI costs by minimizing the amount of irrelevant and unresponsive documents that are reviewed by humans.

3. Using Sampling to Ensure Proportionality

The use of sampling can be incorporated into the joint e-discovery plan to ensure proportional e-discovery burdens and help streamline the negotiation of search terms. Sampling is the process of inferring information about a full document set based on a review of a randomized sample. Sampling helps to provide cost estimates of a full review, offers quality control by ensuring categorizations are properly applied and supplies an initial indicator of whether the costs of a full review outweigh its likely benefit. Each of these barometers allows the parties to eliminate unnecessary review and identify and remedy disputes before incurring costs.

Fed. R. Civ. P. 26(b)(1)'s recent express addition of proportionality in the relevance definition enhances sampling's value. The use of sampling and advanced culling can ensure that the parties have similar burdens in the amount of ESI to review for relevance. Ultimately, sampling ensures right-sizing the parties' e-discovery obligations by encouraging the use of targeted collections of ESI.

4. Limiting ESI to Relevant Custodians/Search Terms/Time Periods

Reducing the number of documents to be searched and collected correspondingly decreases costs by identifying and limiting the scope of e-discovery. Using pertinent search terms, custodians and time periods to eliminate unresponsive and irrelevant documents from batches is highly advisable. The parties should work together to identify and refine this information and include the chosen limitations in the joint e-discovery plan. This information can be amended (within reason) if the review reveals additional information to be searched that initially was unknown. The goal is to prioritize the discovery to narrow the issues in the case and/or arrive at an early resolution of the dispute.

The joint exercise of negotiating these terms has independent value. It requires the parties to work together to solve a common goal, ideally building rapport and an expectation of cooperation. It further requires the parties to engage in an early identification of desired discoverable information and pinpoint and resolve early discovery disputes.

5. Incorporating a Dispute Resolution Provision to Ensure Cooperation

Cooperation between counsel in resolving discovery disputes is critical to reducing ESI-related costs. Obstinacy on discovery positions can unnecessarily increase litigation costs, disrupt rapport with opposing counsel and cause a substantial delay in case resolution – all undesired outcomes. Jointly generating a provision enumerating the manner in which ESI discovery disputes will be resolved encourages efficient and effective dispute resolution.

Collective agreement on the provision's language is critical, because giving both parties control creates ownership and accountability and maximizes the likelihood they will adhere to the chosen dispute resolution procedure. When an ESI-related dispute arises, a dispute resolution procedure could provide for joint consultation between technical experts and/or seeking third-party assistance from a neutral skilled in ESI issues. The dispute resolution provision can also consider cost-shifting to alleviate inequitable cost allocation and exclude unnecessary discovery. Since discovery disputes (however large or small) are virtually unavoidable in modern-day litigation, including a dispute resolution provision in a joint e-discovery plan can help curtail costs and expedite case resolution.

Conclusion

As the explosion of electronic data creation continues, e-discovery costs will rise. Developing a joint e-discovery plan can help ensure effective legal project management and reduce the significant costs associated with the e-discovery process.

With any questions, please contact Tony Rospert or Jake Evans.

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