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When a Party Wants to Have Its Cake and Eat It Too: Applying Sword-and-Shield Waiver in Federal Securities Litigation

This article focuses on the increasing amount of defendants in securities class actions hiding behind third-party communications privilege while relying on those same third parties for their defenses, and how plaintiffs can challenge this through the "sword-and-shield" doctrine.

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Myth 4: "My third-party cloud vendor assumes these risks."

Credit: Destina/Adobe Stock

The Sixth Circuit recently ruled in a securities class action, in relevant part permitting a corporate defendant to withhold, as privileged, documents concerning an internal investigation of the alleged fraud. *In re FirstEnergy Corp.*, 154 F.4th 431 (6th Cir. 2025). This decision is notable not only for what the Sixth Circuit held, but what it did not. Although the defendant proffered the information obtained from its internal investigation as part of its defense in the underlying litigation, the Sixth Circuit did not discuss whether defendant had waived privilege by affirmatively introducing the very evidence it simultaneously sought to protect.

In comparison, other recent securities cases, such as *In re Anadarko Petroleum Corporation Securities Litigation*, have held when a party chooses to rely on third-party audit, diligence, or investigatory materials as a defense, it thereby waives any assertion of privilege over those materials. See *In re Anadarko Petroleum Corporation Securities Litigation,* 2023 WL 2733401 (S.D. Tex. 2023). This article seeks to review some of those cases to discuss the scope of the so-called "sword-and-shield waiver," and its impact on securities litigation.

Sword-and-shield waiver is a type of implied privilege waiver, where a court determines, as a matter of fairness, that a party waives privilege by putting potentially-designated material "at issue" in a litigation. This often occurs when a party asserts a third-party reliance defense, and simultaneously withholds communications with or concerning that third party or its actions. As the Second Circuit explained in perhaps the seminal case on sword-and-shield waiver, if a party "asserts a claim that in fairness requires examination of protected communications," it cannot then withhold the communications as privileged. *United States v. Bilzerian*, 926 F.2d 1285, 1292 (2d Cir. 1991).

In other words, any time a party (1) introduces evidence, including through assertions of affirmative defenses, yet (2) simultaneously seeks to protect parts of that evidence or underlying communications as privileged, (3) fairness requires that the adversary be permitted to examine the evidence relied upon and the underlying communications. For example, sword-and-shield waiver would apply if a party (1) asserts that it did not misstate financials because an auditor's report exculpates it, yet (2) withholds as privileged certain communications between itself and the auditor. In such a scenario, the party proffering the purportedly exculpatory evidence must choose: it may introduce the evidence to support its case (the "sword"), or it may protect the privileged material from disclosure (the "shield"). It cannot do both.

Securities litigation cases often present paradigmatic illustrations of sword-and-shield waiver. These cases may involve corporate defendants claiming their allegedly fraudulent actions had been blessed by auditors or consultants, or excused by after-the-fact special litigation committee investigations. However, in raising the sword of third-party reliance, a party commensurately loses its right to shield third party communications as privileged.

The *Anadarko* illustrates this application of the sword-and-shield doctrine in the class action securities litigation context. The *Anadarko* corporate defendant retained outside counsel to conduct an internal investigation in part to rebut the class action federal securities complaint's allegations. After conducting the investigation, outside counsel presented its purported findings to the SEC, which in turn explained it did not intend to recommend an enforcement action "[b]ased on the information we have as of this date."

Unsurprisingly, the class action securities defendant grabbed its sword and presented the no-enforcement letter as exculpatory evidence. At the same time, however, it also reached for its shield, asserting privilege over the very documents and communications underlying the internal investigation and findings presented to the SEC. The district court did not permit this use of both sword and shield and held that by proffering the no-enforcement letter for exculpatory evidential purposes, defendants thereby waived work-product and attorney-client privilege: defendant "can't now selectively withhold documents and defend itself through such use of the SEC's termination letter, while simultaneously restricting [plaintiff's] access to the underlying facts." *Anadarko Petroleum Corp. Sec. Litig.*, 2023 WL 2733401, at *5.

A similar issue occurred in *Sheet Metal Workers Nat'l Pension Fund v. Bayer Aktiengesellschaft,* 2024 WL 74928, at *2-3 (N.D. Cal. 2024), where defendant's alleged misstatement hinged on whether it conducted adequate due diligence into an acquisition. The defendant asserted as an affirmative defense that it relied on third party attorneys' advice in conducting due diligence, yet nevertheless asserted privilege over communications with those very third parties. The district court, focusing on that party's choice to put the actions of those attorneys into evidence as a due diligence defense, held that defendant waived privilege over those communications under the sword-and-shield doctrine.

At the same time, courts had concluded that the sword-and-shield doctrine does not apply when parties disclaim reliance on exculpatory evidence. For example, *Utesch v. Lannett Co., Inc.,* 2020 WL 7260775 (E.D. Pa. 2020), involved alleged misstatements about pricing, and defendants hired external counsel to conduct an investigation into the question of whether the pricing itself was fraudulent. Defendants asserted privilege over

materials relating to this investigation, but the court held there had been no waiver, noting that defendants had not explicitly asserted an affirmative defense or otherwise brought the investigation into the litigation. Nevertheless, the Utesch court was careful to note that if defendants opted to rely on the investigatory report or any associated evidence moving forward, plaintiffs could re-raise the issue of waiver.

These cases present some takeaways for practitioners' use. First, courts have made clear that a party affirmatively placing a third party's opinion, investigation, or audit at issue in a litigation forecloses the assertion of privilege over related communications. Second, what it means to put a subject matter "at issue," such that a party is deemed to have waived privilege, often depends on the scenario.

In sum, while reliance on a third party can be an important defense in securities class action litigation, parties that invoke such reliance may do so at their own peril. From the plaintiff's perspective, a party asserting reliance on a third party as an affirmative defense—or any affirmative act putting that third party's communications at issue—presents an opportunity to challenge assertions of privilege under sword-and-shield waiver. From a defendant's perspective, parties should carefully consider a decision to assert reliance on a third party, as it may result in corresponding privilege waiver.

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