

CONDUCTING INTERNAL INVESTIGATIONS

Brian A. Herman, Mary M. Dunbar, Steven M. Malina
Morgan, Lewis & Bockius LLP

Financial Industry Regulatory Authority, Inc. (FINRA) Institute
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PRESENTATION OVERVIEW

1. Why conduct an internal investigation?
2. How best to conduct an effective internal investigation (i.e., what are the key ingredients)?
3. What are the key issues confronting anyone charged with conducting an internal investigation?

Definition of an Internal Investigation

- A technique for responding to allegations of management or employee misconduct that assures corporate compliance with a wide range of federal and state regulatory statutes.
- A mechanism for avoiding or resolving threatened government action or shareholder suits and for discovering and halting misconduct that, if unchecked, might ultimately result in corporate criminal or civil liability.

Whether to Investigate: Pros and Cons

PROS	CONS
<ul style="list-style-type: none">■ Uncover and stop illegal conduct	<ul style="list-style-type: none">■ Likelihood of detection may be small
<ul style="list-style-type: none">■ Formulate a defense to possible charges / allegations	<ul style="list-style-type: none">■ Can provide a roadmap to government and plaintiffs' bar
<ul style="list-style-type: none">■ Evaluate proactive disclosure to government or authorities	<ul style="list-style-type: none">■ Cost may be substantial
<ul style="list-style-type: none">■ Sarbanes-Oxley may require investigation	<ul style="list-style-type: none">■ Internal corrective action may be sufficient

Incentives for Conducting Internal Investigations

- SEC Voluntary Disclosure Program (Bounties)
- Criminal Sentencing Guidelines
- Caremark Decision
- SEC's 21(a) Report on Voluntary Cooperation (Seaboard)
- Sarbanes-Oxley

The SEC's Seaboard 21(a) Report A Framework for Cooperation

- SEC Rel. No. 34-44964 (Oct. 23, 2001)
- Established 13 criteria to evaluate and credit corporate behavior
- Four broad categories:
 - Self-policing before discovery of the misconduct
 - Self-reporting misconduct when it is discovered
 - Remedial measures
 - Cooperation with law enforcement authorities

Sarbanes-Oxley: Whistleblower Protection

- Companies may not “discharge, demote, suspend, threaten, harass, or in any manner discriminate against” a whistleblower-employee
- Whistle blowing is lawfully providing securities fraud information to:
 - a federal regulatory or law enforcement agency
 - any member or committee of Congress
 - any person with supervisory authority over the employee or the authority to investigate misconduct within the company
- Companies may not retaliate against an employee for participating in a proceeding concerning securities fraud
- Private cause of action for employees
- Audit committees of companies must establish procedures allowing employees to submit, confidentially and anonymously, concerns regarding questionable accounting or auditing matters

Commencing an Investigation Getting Started

Key Issues Facing Companies Undertaking an Internal Investigation

- Who in the enterprise controls the investigation?
- Who should conduct the investigation?
- How should the investigation be conducted?
- What should the scope of the investigation be?
- What will be done with the results of the investigation?

Commencing an Investigation Who Has Control

- Who Within the Enterprise Should Control the Investigation?
 - Enterprise must identify a credible, untainted decision-maker
 - Compliance Department?
 - Law Department?
 - Management?
 - Board of Directors? (Audit Committee, Special Committee)
 - Outside Counsel?
 - Enterprise must balance benefits of control over the investigation with need for investigator to be independent in fact and appearance

Commencing an Investigation

Who Investigates

- Who Investigates? **Credibility** Is Key
 - Identify key constituencies
 - Identify an investigator with credibility with those constituencies
 - Identify the person to whom the investigator reports and empower the decision-maker with the power necessary to achieve credibility

Establishing Credibility

Identify the Possible Constituencies to Be Reached

Management?

Employees?

Regulators?

Prosecutors?

Congress?

Public investors?

Institutional investors?

Customers?

Lenders?

Business partners?

Press?

Establishing Credibility

Identify an Investigator with Credibility with Those Constituencies

In-House Counsel	Outside Counsel
<ul style="list-style-type: none"> ▪ Less Expensive 	<ul style="list-style-type: none"> ▪ More Objectivity
<ul style="list-style-type: none"> ▪ Familiarity with enterprise 	<ul style="list-style-type: none"> ▪ Easier to stand up to management, if necessary
<ul style="list-style-type: none"> ▪ Familiarity with industry 	<ul style="list-style-type: none"> ▪ Perception of seriousness by government
<ul style="list-style-type: none"> ▪ Permits management greater control over the subjects and scope 	<ul style="list-style-type: none"> ▪ May have more resources
	<ul style="list-style-type: none"> ▪ Ensures that potential wrong-doers are not involved in the investigation
	<ul style="list-style-type: none"> ▪ If in-house counsel is also an officer, attorney-client privilege may be compromised by argument that counsel is acting in a business -- not a legal -- capacity

Establishing Credibility – Who Investigates?

Regular outside counsel versus special outside counsel?

- Regular outside general counsel
 - Close relationship, familiarity with enterprise
 - Could have involvement in subject matter

- Special outside counsel
 - No appearance of conflict of interest
 - Expertise
 - Credibility

Conducting the Investigation Maintaining Privilege

Guard the privilege from the outset

- Structure the investigation to maintain privilege
- Be careful about the role of accountants
 - Use of auditors may result in waiver
 - Sarbanes Oxley restricts use of auditors
- Recognize the possibility or likelihood of waiver
- Remember the “*New York Times Rule*”

Conducting the Investigation Consider Privilege Issues Carefully

- Applicability of the **Attorney-Client Privilege** to an internal investigation may turn on whether its principal purpose is to *provide legal advice*
- **Work Product** protection may turn on whether materials were prepared with *an eye toward litigation*
- Consider what underlying investigative materials will be privileged
- Consider merits of voluntary disclosure to government

Conducting the Investigation Selective Waiver of Privilege

- Voluntary disclosure to the government may waive privilege as to third parties even with a confidentiality agreement
- Recent case law is divided, but leans towards rejection of selective waiver doctrine
- Nonetheless, some recent cases uphold selective waiver for disclosure to the government subject to a confidentiality agreement

Conducting the Investigation

First Things First

- Stop the suspect conduct
- Stop the suspect conduct
- Stop the suspect conduct

Conducting the Investigation

Don't Make It Worse

- Don't speak from ignorance
 - Avoid the instantaneous denial
 - Avoid the quick explanation, however tempting

- Exercise control
 - Get control of the evidence
 - Get control of the speakers

**IN THE CORPORATE WORLD THE COVER UP IS
ALWAYS WORSE THAN THE CRIME**

Conducting the Investigation Don't Make It Worse

- Preserve the evidence
 - Documents
 - Document destruction and cover up may be worse than the original alleged conduct (e.g., Arthur Andersen, Frank Quattrone)
 - Electronic records, including emails
 - Understand the company's IT and back-up environment
 - Take care in communicating with the IT department

Conducting the Investigation

Define the Scope of the Investigation

Define the scope of the investigation

- Time constraints (DOJ leniency program can establish a race)
- Often defined by inquiry from SEC, U.S. Attorney, IRS or other government agency or by a shareholder or derivative suit
- Receipt of information of employee misconduct may trigger investigation and suggest scope
- Watch out for the artificially narrow investigation

Conducting the Investigation Conduct Preliminary Inquiry

- Counsel should conduct a preliminary inquiry to identify sources of information and refine the scope of the project
 - Identify key players
 - Locate and obtain access to relevant information
 - Review any prior investigative records
 - Coordinate with government entities, if appropriate

Conducting the Investigation

Find Out What Happened and Why

Master the Facts

- Documents, documents, documents
 - Pre-assembled corporate documents (e.g., 10K, 10Q, 8-K)?
 - Files of outside and inside counsel?
 - Work papers of outside and inside auditors?
 - Central filing system?
 - Employee files?
 - Raw corporate data?

Conducting the Investigation Find Out What Happened and Why

- Pay attention to what's *missing* in reviewing documents and data
- Index the documents and data
- Interviews
 - Questionnaire?
 - Telephone interviews?
 - *Formal, in-person interviews of all key witnesses*
- Make clear whom you represent
 - Make clear who owns the attorney-client privilege
 - Disclose possible need to waive attorney-client privilege
 - Request cooperation from employees

Conducting the Investigation Current and Former Employees

- Determine what to do with current employees involved in conduct at issue
 - Suspend?
 - Reassign?
 - Discipline or fine? (Consider whether reporting required)
 - Dismiss?
 - Arrangements for individual legal counsel?
 - Employees refusing to submit to interviews may be fired
 - Invoking Fifth Amendment constitutes a breach of employee's duty of loyalty to corporation and is good grounds for termination.

Conducting the Investigation

Communicate Honestly

- Tailor communication to reflect status
- Tailor communications to constituencies
 - Regulators and prosecutors want facts
 - Shareholders want accurate and timely disclosure
 - Lenders want repayment assurances
 - Customers and suppliers want financial security
 - Injured parties want recompense
- Don't over promise
- Avoid surprises
- Communicate for credibility

Conducting the Investigation

Re-evaluate Strategy

Be prepared to re-evaluate strategy constantly

- New findings from investigation
- Questions from regulators or other government agencies
- Press reports

Conducting the Investigation Memorializing Interviews

- Generally avoid transcription or tape recording
- Prepare interview memoranda carefully
 - Document preliminary disclosures and warnings
 - Prepare and complete promptly
 - Control access
 - Remember privilege
 - Be prepared for waiver

Conducting the Investigation Memorializing the Findings

- Written or oral report?
 - Written report may be subject to discovery in civil litigation brought against the company
 - In some cases, an oral report may be preferable

- If written, who should receive copies?
 - Government?
 - Only Board of Directors?
 - May be dictated by scope of investigation and interest of regulators

Conducting the Investigation Memorializing the Findings

What level of detail is appropriate?

- If purpose of report is to persuade the SEC or other government agency that it need not continue its own investigation, a highly detailed report may be necessary
- If no government investigation or shareholder action is pending or threatened, less detail may suffice

Should comments be solicited?

- Allows correction of inadvertent factual inaccuracies
- Risks delay and contradictory submissions

What style and tone should be used?

Conducting the Investigation

What to do with results and work product?

Will the company notify the government?

- Mandatory disclosure of regulated industries if known or suspected unlawful or criminal behavior (e.g., banks, NASD Rule 3070 – Reporting Requirements)
- “Good corporate citizen” questions
 - Waiving the privilege can demonstrate willingness to cooperate
 - Ethical obligation to employees
- Reasons to notify government:
 - Able to frame the story
 - Can help escape prosecution
 - Can lead to a more lenient treatment if prosecution results
 - Can avoid a disruptive government investigation
- Reasons *not* to notify the government
 - Adverse publicity
 - Chilling effect on future cooperation
 - Possible privilege waiver and roadmap provided to plaintiff’s bar

Summary - Credibility is Key

It's Credibility, Credibility, Credibility

**IN THE CORPORATE WORLD THE COVER UP IS
ALWAYS WORSE THAN THE CRIME**

DOJ CHARGING FACTORS

Conducting the Investigation Considering Voluntary Disclosure

- Under **DOJ Guidelines** (Jan. 20, 2003), voluntary waiver of privilege may help a corporation avoid prosecution
- Prosecutors will consider a corporation's willingness to:
 - identify culprits
 - make witnesses available
 - disclose complete results of an internal investigation
 - waive attorney-client privilege
- Waiving privilege may result in reduced sentencing

Summary - Key Points

- Stop the suspect conduct
- Determine need for investigation
- Control privilege
- Don't make it worse
- Establish credibility
- Assemble the requisite team
- Get the facts straight
- Communicate honestly
- Constantly re-evaluate strategy
- Memorialize findings appropriately

Extra

- Voluntary disclosure to the government may waive privilege as to third parties even with a confidentiality agreement
- Recent case law is divided, but leans towards rejection of selective waiver doctrine:
 - In re Columbia/HCA Healthcare Corp., 293 F.3d 289 (6th Cir. 2002)
 - Bank of Am. v. Terra Nova Ins. Co., 212 F.R.D. 166 (S.D.N.Y. Dec. 19, 2002)
 - In re Bank One Sec. Litig., 209 F.R.D. 418 (N.D. Ill. July 31, 2002)
 - United States v. Bergonzi, CR-00-0505 (N.D. Cal. Jan. 10, 2003)
- Nonetheless, some recent cases uphold selective waiver for disclosure to the government subject to a confidentiality agreement:
 - Maruzen Co. v. Yakult Honsha Co., 2002 WL 1628782 (S.D.N.Y. July 23, 2002)
 - Saito v. McKesson HBOC, Inc., 2002 WL 31657622 (Del. Ch. Nov. 13, 2002)