

CONDUCTING INTERNAL INVESTIGATIONS

Mary Dunbar and Anne Flannery
Morgan Lewis

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PRESENTATION OVERVIEW

1. Why conduct an internal investigation?
2. What are some of the key issues faced when considering whether and how to conduct an internal investigation?
3. What are best practices for conducting an effective internal investigation?
4. How has the current economic climate affected “best practices” for internal investigations?

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 self-regulatory organization, civil, or criminal actions
- A means of establishing “cooperation” credit with regulators

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's 21(a) Report on Voluntary Cooperation (Seaboard) (2001)
- FINRA Guidance Regarding Credit for Extraordinary Cooperation (Notice 08-70) and Sanction Guidelines
- Sarbanes-Oxley Act of 2002
- DOJ Guidelines

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

FINRA Regulatory Notice 08-70

- First formal guidance issued by FINRA since the July 2007 merger of NASD and NYSE Regulation.

- Extraordinary Cooperation
 - Factors to Determine Level of Cooperation:
 - Proactive and Early Self-Reporting of Violations
 - Extraordinary Steps to Correct Deficient Procedures and Systems
 - Extraordinary Remediation to Customers
 - Providing Substantial Assistance to FINRA Investigations

FINRA Regulatory Notice 08-70

- Effects of Credit for Extraordinary Cooperation:
 - Reduction of Fine Required for Settlement
 - Dispense with Required Undertaking or Reduce Scope
 - Cooperation Reflected in Settlement Document and Press Release
 - Potential for No Disciplinary Action

FINRA Sanction Guidelines

- FINRA Sanction Guidelines consider:
 - whether a firm accepted responsibility for and acknowledged the misconduct prior to detection and intervention by a regulator;
 - whether a firm voluntarily employed subsequent corrective measures, prior to detection or intervention by a regulator, to revise procedures to avoid recurrence of misconduct; and
 - whether the firm provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct, or whether the firm attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA.

Sarbanes-Oxley Act of 2002

- Audit committees of public companies must establish procedures allowing employees to submit, confidentially and anonymously, concerns regarding questionable accounting or auditing matters.
- Companies may not “discharge, demote, suspend, threaten, harass, or in any manner discriminate against” a whistleblower-employee
- Whistleblowing 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; employees have private cause of action

DOJ Guidelines

- Factors to be considered in determining whether to prosecute a corporation include:
 - The corporation's timely and voluntary disclosure of its wrongdoing and its willingness to cooperate in the investigation of its agents
 - The corporation's remedial actions including any efforts to:
 - Implement an effective corporate compliance program (or improve an existing one)
 - Replace responsible management
 - Discipline or terminate wrongdoers
 - Pay restitution
 - Cooperate with the relevant government entities.

DOJ Guidelines

- Gauging extent of cooperation:
 - Voluntary and timely disclosure
 - Willingness to provide relevant information and evidence
 - Identification of relevant actors

- Benefits of cooperation:
 - Cooperation is a potential mitigating factor by which a corporation can gain credit.
 - Enables government to focus its resources in a manner that will not unduly disrupt the corporation's legitimate business operations.

Preliminary Considerations

- Stop suspect conduct
- Protect ability to claim attorney-client privilege and assert work product doctrine

Preliminary Considerations

Stop Suspect Conduct

- Stop the suspect conduct ASAP; do not permit it to continue while investigation is ongoing

Preliminary Considerations Protect Privilege

- 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

Preliminary Considerations Protect Privilege

- While firm may choose to waive privilege at a later time, best practice is to structure the investigation at the outset to maintain privilege
- While voluntary disclosure to the government may reduce potential penalty, it may waive privilege as to third parties (e.g., private plaintiffs) even with a confidentiality agreement
 - While a few courts have upheld confidentiality agreements, most court reject selective waiver doctrine
- Be careful about the role of accountants
 - Use of auditors may result in waiver
 - Sarbanes Oxley restricts use of auditors

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

Commencing the Investigation

Possible Constituencies to Be Reached

Management?

Employees?

Regulators?

Prosecutors?

Congress?

Public investors?

Institutional investors?

Customers?

Lenders?

Business partners?

Press?

Commencing the Investigation In-house and/or Outside Counsel

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"> ▪ Avoids having potential wrong-doers involved in the investigation
	<ul style="list-style-type: none"> ▪ Protects privilege: attorney-client privilege may be compromised by argument that in-house counsel is acting in a business -- not a legal -- capacity if he or she serves multiple functions

Commencing the Investigation

Regular 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
 - Cost and efficiency

Conducting the Investigation

Define the Scope of the Investigation

- Often defined by inquiry from FINRA, SEC, U.S. Attorney, or other government agency or by a shareholder or derivative suit
- Receipt of information of employee misconduct may trigger investigation and suggest scope
- Consider time constraints
- 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 Preserve Evidence

- Before investigators develop a complete list of documents to gather and review, there may be a need to take steps to preserve evidence by circulating document preservation directive
 - 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 Find Out What Happened and Why

- Master the facts
- Consider possible sources of relevant documents:
 - Pre-assembled corporate documents?
 - Files of outside and inside counsel?
 - Central filing system?
 - Employee files?
 - Raw corporate data?
- As documents and data are reviewed, pay attention to what's missing
- Index the documents and data

Conducting the Investigation Find Out What Happened and Why

Interviewing Employees

- Method:
 - Questionnaire?
 - Telephone interviews?
 - *Formal, in-person interviews of all key witnesses*

- Provide Cautions
 - 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
 - Inform employee that DOJ may take the position that lying to company investigator is lying to government where employee knows statements may be shared with government agency

Conducting the Investigation Memorialize 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

Re-evaluate Strategy

Be prepared to re-evaluate strategy constantly

- New findings from investigation
- Questions from regulators or other government agencies
 - Avoid instantaneous denial or quick explanation before investigation is complete, however tempting
- Press reports – Remember the New York Times Rule

Conducting the Investigation

Identify Potential Employee Issues

- 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

- Form U4 and U5 issues

Conducting the Investigation Memorialize 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 Memorialize the Findings

What level of detail is appropriate?

- If purpose of report is to persuade FINRA or 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?

- Disclosure may be required by rule or strongly encouraged by guidance issued by regulator
- 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 - Key Points

- Stop the suspect conduct
- Determine need for investigation
- Preserve privilege
- Establish credibility
- Assemble the requisite team
- Get the facts straight
- Regularly re-evaluate strategy
- Memorialize findings appropriately
- Notify regulators if required or appropriate

Waiver of Privilege to Regulators Is Not Necessary

- Previously, the SEC, NYSE, and DOJ regarded waiver of privilege as an element of cooperation.
- SEC Enforcement Manual:
 - “The staff must respect legitimate assertions of the attorney-client privilege and attorney work product privilege, unless a party voluntarily chooses to waive a privilege.”
 - **and italics:** “The staff should not ask a party to waive the attorney-client or work product privileges and is directed not to do so.”
- FINRA Regulatory Notice 08-70 states that “the waiver or non-waiver of the privilege itself will not be considered in connection with granting credit for cooperation.”
- DOJ no longer considers whether a corporation has waived the attorney-client privilege or work product protection in determining whether a corporation has cooperated with the government’s investigation.

SEC Enforcement Manual

- In an effort to address some criticisms and make its processes more transparent, the SEC made public its Division of Enforcement Manual in October 2008.
- A version of this document (the “Red Book”) has long been used by the Division’s staff as a guide to conducting investigations.
- The manual sets forth standard practices for key SEC Enforcement processes.
- The manual is intended to provide guidance to the staff and may not be relied upon to create rights enforceable by parties in SEC matters.

Production of Documents to the SEC Pursuant to a Confidentiality Agreement

- The staff may agree to enter into a confidentiality agreement to assist a producing party to maintain confidentiality and/or privilege.
- The manual provides a “model” form of a confidentiality agreement, but the staff may not modify it without authorization from the Office of Chief Counsel and/or Head of the Trial Unit.
- The model confidentiality agreement is particularly important to entities that may be inclined to produce potentially privileged documents.
 - However, a confidentiality agreement does not necessarily protect a party from a claim of waiver of privilege by third parties.

Cases on Privilege Waiver

- Voluntary disclosure to the government may waive privilege as to third parties even with a confidentiality agreement. Case law is divided, but leans toward rejection of selective waiver doctrine:
 - In re Columbia/HCA Healthcare Corp., 293 F.3d 289 (6th Cir. 2002)
 - In re Qwest Comm'ns Int'l Inc. Sec. Litig., 450 F.3d 1179 (10th Cir. 2006)
 - In re Initial Public Offering Sec. Litig., 2008 U.S. Dist. Lexis 11058 (S.D.N.Y. Feb. 14, 2008)
 - In re Bank One Sec. Litig., 209 F.R.D. 418 (N.D. Ill. July 31, 2002)
 - U.S. v. Reyes, 239 F.R.D. 591 (N.D. Cal. 2006)

- Nonetheless, some cases uphold selective waiver for disclosure to the government subject to a confidentiality agreement:
 - In re Cardinal Health Inc. Sec. Litig., 2007 U.S. Dist. Lexis 36000 (S.D.N.Y. Jan. 26, 2007)
 - Saito v. McKesson HBOC, Inc., 2002 WL 31657622 (Del. Ch. Nov. 13, 2002)

Resources

- Internal Corporate Investigations, ABA Section on Litigation, Brad D. Brian and Barry F. McNeil, Editors
- Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations, American College of Trial Lawyers
- Corporate Investigations and White Collar Desk Book, Morgan, Lewis & Bockius LLP