
CONDUCTING INTERNAL INVESTIGATIONS

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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's 21(a) Report on Voluntary Cooperation (Seaboard) (2001)
 - January 4, 2006, "Statement of the Securities and Exchange Commission Concerning Financial Penalties."
 - NYSE Information Memo 05-65 and FINRA Sanction Guidelines
 - Sarbanes-Oxley Act of 2002
 - DOJ Guidelines and Criminal Sentencing Guidelines
 - Caremark Decision
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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

NYSE Information Memo 05-65

- **Extraordinary Cooperation:**
 - “Firms that provide the Exchange with prompt, detailed reporting of suspected or uncovered violations stand in sharp contrast to firms whose report filings provide perfunctory attempts to meet the bare letter of disclosure requirements. Even better situated are firms that follow early disclosure with vigorous and thorough internal reviews, that share the facts discovered with the Exchange, and that compensate customers (and others) who may have been harmed.”
 - Waiver of attorney-client privilege “may demonstrate a level of commitment to the Exchange's investigation, by a firm or by an individual, sufficient to advance a claim of exceptional cooperation.”

FINRA Sanction Guidelines

- FINRA Sanction Guidelines consider:
 - whether a firm accepted responsibility for and acknowledged the misconduct a regulator 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;
 - 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

- 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
- 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; employees have private cause of action

Conducting the Investigation Considering Voluntary Disclosure

- Under **DOJ Guidelines** (Jan. 20, 2003), (the "Thompson Memo") 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
 - The DOJ's Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006) (the "McNulty Memo") (i) recognizes that waiver of privilege is not a prerequisite to finding that a company has cooperated; (ii) states that a prosecutor may only request waiver when there is a "legitimate need"; and (iii) requires supervisory sign-off for a request for waiver.
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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
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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
■ Less Expensive	■ More Objectivity
■ Familiarity with enterprise	■ Easier to stand up to management, if necessary
■ Familiarity with industry	■ Perception of seriousness by government
■ Permits management greater control over the subjects and scope	■ May have more resources
	■ Avoids having potential wrong-doers involved in the investigation
	■ 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

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

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 over persons who may be speaking on behalf of the entity about the matter

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

- *Qualcomm Inc. v. Broadcom Corp.*: failure to conduct reasonable inquiry into adequacy of document search and consequent failure to produce documents can lead to sanctions.

Conducting the Investigation

Define the Scope of 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
- 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

Find Out What Happened and Why

Master the Facts

- Documents, documents, documents
 - Pre-assembled corporate documents?
 - Files of outside and inside counsel?
 - 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

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.
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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

Re-evaluate Strategy

Be prepared to re-evaluate strategy constantly

- New findings from investigation
- Questions from regulators or other government agencies
- Press reports – Remember the New York Times Rule

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 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
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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.

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
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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 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*, 216 F.R.D. 487 (N.D. Cal. 2003)
 - Nonetheless, some 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)
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Resources

- Internal Corporate Investigations, ABA Section on Litigation, Brad D. Brian and Barry F. McNeil, Editors (2007)
- Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations, American College of Trial Lawyers (February 2008)
- Corporate Investigations and White Collar Desk Book, Morgan, Lewis & Bockius LLP (2006)