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DOING BUSINESS IN THE GOLDEN STATE: CONDUCTING INTERNAL INVESTIGATIONS

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Agenda

- The Basics Behind Internal Investigations
- Best Practices when Conducting Internal Investigations
- Post-Investigation Issues

Hypothetical: The Complaint

- Donna has been a VP in Finance at Tech Co. for 2 years.
- She sends you (Tech Co.'s General Counsel) a letter and discloses, for the first time, that the CFO and other senior finance personnel in her group have been "cooking the books" in order to reach revenue targets and boost earnings guidance. Specifically, she alleged that the CFO was pressuring her to accelerate revenue by channel stuffing. Donna also claims one of Tech Co.'s biggest deals for last quarter was backdated – without this deal, the company would not have met its projected revenue for the quarter (which it had already missed the previous quarter).
- She has spoken to a lawyer and is demanding that Tech Co. look into this matter and take appropriate remedial measures. She believes she may be fired because she pushed back on the CFO's improper tactics. You learn later that Donna was on a RIF list and has had consistently poor performance reviews.

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THE BASICS BEHIND INTERNAL INVESTIGATIONS

What Triggers an Investigation

- Triggers:
 - Financial or accounting improprieties
 - Misleading disclosures
 - Bribery
 - Insider trading
 - Code of conduct issues
 - Retaliation
- Communicated through:
 - Whistleblower complaint
 - Ethics hotline
 - Concerns from internal audit or compliance review
 - Outside auditors
 - Government subpoena



Key Players

- Whistleblower(s)
- In-house legal counsel and / or compliance team
- Outside counsel (retained by the company, board committees and/or officers)
- Management and other employee witnesses
- Human Resources
- Internal and external auditors
- Public Relations / Crisis Communications teams
- SEC, DOJ and other state / federal regulators

Whistleblowers

- Assume a whistleblower has or will contact the SEC
- Whistleblowers can receive between 10 and 30% of penalties collected in an enforcement action which exceed \$1 million
- Proposed amendments would permit the SEC to (1) increase awards below \$2 million and (2) decrease awards over \$30 million
- Dodd Frank anti-retaliation provisions: SEC can take legal action against employers who have retaliated against whistleblowers; private right of action



In the Matter of Homestreet, Inc. (No. 799844)

- January 2017 – HomeStreet Inc. charged with improper hedge accounting and “taking steps to impede potential whistleblowers.”
- Management asked multiple employees if they had raised issues with the SEC or knew the identify of the whistleblower
- Company suggested it could deny indemnification payments to an individual if they were the whistleblower
- SEC’s Response:
 - *“Companies that focus on finding a whistleblower rather than determining whether illegal conduct occurred are severely missing the point.”*
 - *“Companies simply cannot disrupt the lines of communications between the SEC and potential whistleblowers.”*

Investigation Goals

- Once an investigation is initiated, it should be thorough enough to determine:
 - Nature and duration of improper conduct
 - Identify those involved
 - Whether management participated in, were aware of, or otherwise condoned the activity
 - How to fix or resolve the issues discovered
- Guiding principle is that the investigation should be *reasonable* in light of the circumstances

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BEST PRACTICES WHEN CONDUCTING INTERNAL INVESTIGATIONS

The Process is as Important as the Discovery of Facts



- Respond promptly
- Assess what kind of immediate actions may be required
- Scope out the investigation
- Consider hiring outside counsel and assess conflicts of interest
- Keep your client (internal compliance, Audit Committee Chair or Board representative) updated on progress
- Document the process / plan
- Process is as important as the substance

Assess Potential Conflicts of Interest

- Depending on the allegations, certain senior management may need to be “walled off” from the investigation
 - In Tech Co. hypothetical, the CFO
 - Can include General Counsel and / or entire legal department
- Likely retain individual or pool counsel for these individuals
- Walled-off individuals can have no role in the investigation

Key Consideration – Maintaining Privilege

- Internal investigations are not automatically privileged
- Best practice for company counsel (either internal or external) to lead the investigation
- California's Attorney-Client Privilege
 - Attorney is conducting investigation in order to provide legal advice / services (Cal. Evid. Code §§ 912, 951-952)
- California's Work Product Doctrine
 - Absolute protection for "attorney's impressions, conclusions, opinions, or legal research or theories"; qualified protection for all other attorney work product (CCP § 2018.030)

Key Consideration – Privilege Waiver

- Protections may be waived by disclosure of privileged communications or work product to third party outside the attorney-client relationship (e.g., government)
- If there is a waiver of privilege as to some communications, does it affect privileges as to all communications concerning the investigation?
 - In California, disclosure of a significant part of a privileged communication generally waives the privilege only with respect to that communication.
 - By contrast, under Federal law, voluntary disclosure is generally held to waive the privilege as to all communications between them pertaining to the same subject matter

Preserve the Evidence

- Distribute a Document Hold Notice to all relevant parties
 - Do not destroy or delete any potentially relevant information
 - Applies to electronic and hard-copy data and documents (e.g., notes)
 - Identify a point of contact for any questions
 - May need to remind recipients regarding obligations under the document hold
- Determine whose data should be collected and the different types -- e-mails, chats, texts and phone calls, social media
- Establish key search terms and issues



Prepare for Witness Interviews

- Interviews provide insight on data and documents collected
- Do your research and prepare witness outlines in advance of interviews
- Sequence the interviews to frame the issues and scope, for example:
 - Employee who interviewed Donna
 - Donna (if she will talk)
 - Other VPs in the finance department to provide insight on Donna's credibility and her concerns (lower level at the outset)
 - Senior VPs and the CFO
- Avoid disrupting business operations, but try for in-person interviews

Conducting Witness Interviews

- “*Upjohn Warnings*” should unambiguously explain:
 - (1) that lawyer represents company, not individual,
 - (2) that she is gathering information in order to provide legal advice to the company
 - (3) that interview is privileged and regarded by company as confidential, and substance may not be disclosed to third parties,
 - (4) that the privilege belongs only to the company, which can waive without consent of individual
- Be prepared for witness questions:
 - “*Should I have my own attorney?*”
 - “*Do I have to answer your questions?*”
 - “*I’ll answer your questions, but will you promise not to tell anyone else?*”



Conducting Witness Interviews

- Encourage the witness to open up, but discourage speculation
- Use key documents
- Try to ascertain other witnesses with relevant information and other sources for documents
- Focus on the message, not the messenger
 - Remember HomeStreet: *"Companies that focus on finding a whistleblower rather than determining whether illegal conduct occurred are severely missing the point."*

Conducting Witness Interviews

- Ask witness to identify any other issues or concerns that were not covered
- Remind the witness about maintaining confidentiality and preserving documents
- Explain that you may need to meet with the witness again
- Memorialize your notes from the interview
 - Participants
 - Duration
 - *Upjohn* warnings and witness' acknowledgment
 - Summary of questions asked and information provided
 - Mental impressions and thought processes

Additional Interviews May be Required

- As the facts develop, so does the need to interview additional witnesses and re-interview witnesses, such as Senior VPs that Donna claims were aware of the issues she raised
- Consider interviewing non-employees (e.g., customer involved in the contract that Donna claims was backdated; former employees of Tech Co.)
 - Cannot compel cooperation, but an attempt to interview key witnesses demonstrates thoroughness and process



Investigation “Drifts”

- Hypothetical: During the course of the investigation, facts begin to suggest that one of Tech Co.’s Senior VPs engaged in insider trading
- Considerations in whether to investigate further:
 - Nature of issues discovered
 - Responsibilities of individuals involved
 - Role of management
 - Ability to remediate and solve issue
 - Quality of company's compliance and ethics program
 - Reliability of company's books and records and internal controls
 - Risk profiles

Engaging Consultants and Experts



- Case-by-case determination as to whether forensic accountants or investigative firms are needed
- Key Consideration: Make sure that any consultant involved in the investigation is protected by attorney-client privilege
- Key Consideration for Outside Counsel: Coordinate with consultants and coordinate often

POST-INVESTIGATION ISSUES

Investigative Findings – Reporting the Findings

- Report to Audit Committee or Board
 - Report to full board could be waiver of privilege
- Report to Management
 - Can be waiver of privilege
- Report to Outside Auditors
 - If accounting issues arise, outside auditors will demand to be apprised
 - Privilege is likely waived



Investigative Findings - Drafting a Written Report

- Sometimes a written report is necessary
 - Government may require it
 - Written report may be needed to support dismissal of derivative action
 - When facts are complex, a written report be essential to explain clearly to the audience
 - Provides evidence that overseers of investigation have fulfilled their fiduciary duties
- Disadvantages to a written report
 - Can be discoverable
 - Contents could be used against the company in civil litigation
 - Statements in report may be construed as admissions
 - May result in broader waiver of attorney-client privilege
 - May be unnecessary if determine not to report to government

Investigative Findings - Alternatives to Written Report

- Oral report
 - No Discoverable Document
 - May be deemed less reliable by regulators
 - Less costly to prepare
- Hybrid report
 - An oral report is made that highlights facts as a result of the investigation
 - A PowerPoint presentation that describes the procedures performed supplements the oral report
 - Provide key, non-privileged documents uncovered during investigation
- Consider different reports for different audience

Investigative Findings – Contents of Any Report

- Key Content of Reports
 - Review of allegations
 - Summary of work plan
 - Who was interviewed and how often
 - Sources and volume of data obtained
 - Accounting errors or irregularities noted and financial impact
 - Suggested remedial actions
 - Conclusions if appropriate
- Be accurate, clear, impartial and focus on relevant information



Self-Reporting and Parallel Civil Actions

- Case by case determination on whether to self-report
- Easier situations: (1) no evidentiary support for allegations or (2) findings require public disclosure of material information
- More difficult: Investigation uncovers issues requiring remediation, but the issues are not otherwise material or require disclosure
 - Pros: proactive; demonstrates cooperation; could turn into non-action
 - Cons: no good deed goes unpunished; may need to expand investigation
- One of the biggest concerns with self-reporting is the waiver of privileged communications (e.g., plaintiffs suing the company in civil actions)

THANK YOU

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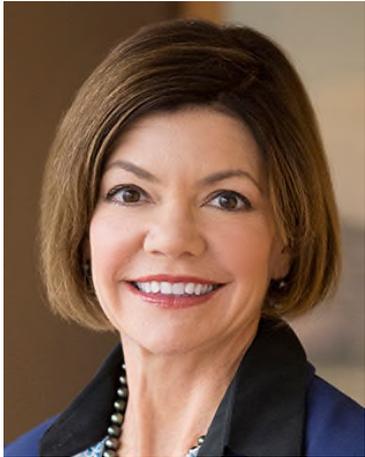
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