

# ALI-ABA BUSINESS LAW

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*Course materials journal*

## How To Conduct Internal Corporate Investigations After Sarbanes-Oxley

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“CCO” refers to Chief Compliance Officer; “CEO,” to chief executive officer; “CLO,” to chief legal officer; “DOJ,” to the U.S. Department of Justice; “NASD,” to the National Association of Securities Dealers; “OIG,” to the Office of Inspector General of the U.S. Department of Health and Human Services; “QLCC,” to qualified legal compliance committee; and “SEC,” to the Securities and Exchange Commission.

### **A. Introduction**

1. The government is showing no signs of curtailing its aggressive and largely successful investigation and prosecution of corporate misconduct. In fiscal year 2002, the most recent year for which statistics are available, the U.S. Department of Justice recovered \$9.8 billion in damages, restitution, and fines for corporate misconduct—nearly twice the amount it recovered just one year earlier—and obtained approximately 6,000 corporate convictions and pre-trial diversions. Contributing to those statistics were sensational corporate scandals like those of Enron, WorldCom, Adelphia Communications, Arthur Andersen, Tyco, and Martha Stewart that have further fuelled suspicion of

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American corporate culture. The federal government has recently undertaken many steps to combat corporate misconduct, including the formation of a new Corporate Fraud Task Force that combines the efforts of the Department of Justice, the SEC, the Department of Treasury, the Federal Communications Commission, and several other government agencies to combat corporate wrongdoing.

2. The Corporate Fraud Task Force (“Task Force”) will also be armed with the Sarbanes-Oxley Act of 2002, an extensive law that imposes new responsibilities on corporations, corporate officers and executives, and even the attorneys who represent them. The SEC continues to evaluate whether to impose “withdrawal” rules under which either an attorney, or alternatively the corporate client, must notify the SEC that an attorney has withdrawn for “professional considerations.” As part of the aftermath of corporate accountability scandals, the ABA amended Model Rules 1.6 and 1.13 to clarify the ethical obligations of attorneys who learn of fraudulent conduct. In this context, the need for corporate compliance programs and internal investigations of potential misconduct is stronger than ever.

## **B. The New Standards Imposed By The Sarbanes-Oxley Act Of 2002**

1. *The Sarbanes-Oxley Act Of 2002.* Sarbanes-Oxley and other recent developments reflect an acceleration of the trend toward requiring corporations to adopt effective compliance programs and initiate internal investigations to deal with allegations of misconduct. For example, section 406 of Sarbanes-Oxley requires disclosure of whether the issuer has adopted a code of ethics for senior financial officers, and if not, why not. Final rules implementing section 406 became effective for annual reports for fiscal years ending after July 15, 2003. Section 404 of Sarbanes-Oxley requires that annual reports include a discussion of the existence and effectiveness of internal control structures, and section 302 requires CEOs and CFOs to certify the truthfulness and accuracy of all material facts, including financial statements and the financial condition of the company. Sarbanes-Oxley imposed obligations on attorneys as well.
2. *Section 307 Of Sarbanes-Oxley: Standards Of Professional Conduct For Attorneys.* Section 307 of the Sarbanes-Oxley Act of 2002 requires the SEC to promulgate rules that set forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission “in any way in the representation of issuers.”

- a. Among the rules that the SEC is required to implement is a rule that:
    - i. Requires an attorney to report “evidence of a material violation” of securities law or breach of fiduciary duty or similar violation by the company or its agent to the chief legal counsel or the chief executive officer of the company; and
    - ii. Requires the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors, if the chief legal counsel or chief executive officer does not appropriately respond.
  - b. On January 23, 2003, the SEC issued the final rules implementing section 307 (“the Rules”). The Rules, which may be found at <http://www.sec.gov/rules/final/33-8185.htm> and in the Federal Register, became effective August 5, 2003.
3. *Attorneys Covered By The Rules.*
- a. *“Appearing And Practicing.”* In response to criticism that the group of attorneys covered by the proposed rules was overly broad, the SEC narrowed the scope of the Rules to apply only to attorneys (whether serving as in-house or outside counsel) who provide legal services or advice regarding the federal securities laws to a ‘34 Act “issuer” in connection with the preparation of documents for filing with the SEC. Although the Rules apply only to attorneys who have established an attorney-client relationship with an issuer, the scope of the Rules is still broad. For instance, the Rules govern attorneys whose advice causes materials not to be submitted to the SEC, as well as lawyers preparing documents that are submitted as exhibits to SEC filings. However, an attorney who prepares a document that was not intended to be submitted to the SEC is not covered by the Rules. This is true regardless of whether the document is actually submitted to the SEC. Attorneys retained or directed by an issuer to investigate evidence of a material violation covered by the Rules are also considered to be “appearing and practicing” before the SEC and have certain obligations under the Rules.
  - b. *“In The Representation”* “In the representation” of an issuer has been defined in the Rules to mean providing legal services as an attorney for an issuer. However, an attorney does not necessarily have to be retained or

empowered by an issuer to be acting “in the representation of an issuer.” Under certain circumstances, activities performed by an attorney for a non-public subsidiary can also be subject to the Rules. For example, an attorney retained under an umbrella representation agreement or understanding under which the attorney represents the parent company and its non-public subsidiaries and can invoke privilege claims with respect to communications involving the parent and its subsidiaries, is subject to the Rules. Similarly, an attorney at a non-public subsidiary acts “in the representation of an issuer” if his or her work is at the direction of the parent and will be incorporated into materials submitted to the SEC by the parent (i.e., periodic reports).

4. *The Obligation To Report Evidence Of A “Material Violation.”* Evidence of a material violation must be reported in all circumstances in which it would be unreasonable for a prudent and competent attorney not to conclude that it is “reasonably likely” that a “material violation” has occurred, is ongoing, or is about to occur.
5. *Definition Of “Material Violation.”* A material violation includes a violation of the federal or state securities laws, a material breach of a fiduciary duty arising under federal or state law or a similar violation of any federal or state law. Although there was some discussion as to whether the original proposed Rules contemplated the application of a subjective standard to determine whether evidence of a material violation existed, the final Rules confirm that an attorney’s actions will be evaluated against an objective standard. Furthermore, to be “reasonably likely,” a material violation must be more than a mere possibility, but it need not be more likely than not.
6. *Up-The-Ladder Reporting Requirements.*
  - a. *Initial Reporting Requirements.* If a determination is made that it is reasonably likely that a material violation has occurred, is occurring, or is about to occur, the attorney is directed to report the matter to the company’s CLO, or to both the CLO and CEO. If an issuer does not have a general counsel or a CLO, the report should be made to the CEO. An attorney is also permitted (but not required) under the Rules to circumvent the CLO and CEO and to report the matter directly to the company’s audit or other independent committee or its board of directors, if the attorney reasonably believes that reporting the material violation to the CLO or CEO would prove futile. The recipient of the report is responsible for investigating the

matter and reporting the results of that investigation to the reporting attorney. If this person, committee, or board of directors concludes that a material violation has occurred, is occurring, or is about to occur, he or she must take reasonable steps to cause the company to adopt appropriate remedial measures and/or sanctions, including appropriate disclosures.

b. *Ensuring An Appropriate Response.* The reporting attorney has not satisfied his or her responsibilities under the Rules by merely making the initial report. Rather, the reporting attorney must determine whether he or she has received an “appropriate response” to the initial report of a potential violation. The reporting attorney must “reasonably believe” that either there is no material violation or that the issuer has taken proper steps to remedy any violation that may have occurred.

i. The circumstances a reporting attorney might weigh in assessing whether he or she could “reasonably believe” that an issuer’s response is appropriate include the amount and weight of the evidence of a material violation, the severity of the apparent material violation, and the scope of the investigation into the report. An issuer will be deemed to have made an “appropriate response” if it reports that it has been advised by an attorney who has conducted an internal review of the reported evidence that it can assert a “colorable defense” in any investigation or proceeding relating to the reported matter. A reporting attorney’s obligations under the Rules will be satisfied upon receipt of what he or she reasonably believes to be an “appropriate response” to his or her report of a material violation of the Rules.

ii. However, if the issuer fails to provide an “appropriate response” within a reasonable time, the reporting attorney must then report that information to the company’s audit committee, or if the company does not have an audit committee, to another committee of independent directors, or if the company does not have another committee of independent directors, to the full board. (As adopted, a director is not “independent” under the Rules if he or she is “employed, directly or indirectly, by the issuer.” However, the SEC anticipates that the definition of an independent director for purposes of new Part 205 will be amended to conform to final rules defining who is an independent director under section 301 of the Sarbanes-Oxley Act.) This “up the ladder” reporting would then conclude the reporting attorney’s obligations under the Rules.

7. *Investigating A Report Of Evidence Of A "Material Violation."*

- a. *Obligations If Retained By Chief Legal Officer.* Under certain circumstances, attorneys retained or directed to investigate or litigate reported violations are not themselves required to report those material violations. When an attorney is retained to investigate a report of a material violation by the CLO, the attorney has no reporting obligation if the results of the investigation are provided to the CLO, and the attorney and CLO each reasonably believes that no violation has occurred, is ongoing or is about to occur, and provided the CLO reports the results of the inquiry to the issuer's board of directors, committee of independent directors or QLCC. If an attorney is retained or directed by the CLO to litigate (as opposed to investigate) a reported violation, he or she is also free of any reporting obligation if he or she can assert a colorable defense on behalf of the issuer and the CLO provides reasonable and timely reports on the progress and outcome of the litigation to the issuer's board of directors, audit committee, committee of independent directors, or QLCC.
- b. *Obligations If Retained By Qualified Legal Compliance Committee.* As an alternative to the previously discussed reporting procedures, the SEC has suggested (but is not requiring) that companies establish a QLCC to investigate reports of material violations made by attorneys. If such a committee is in place, an attorney subject to the Rules will fully satisfy his or her obligations by reporting evidence of a material violation to the QLCC. If a report is made to a properly constituted QLCC, the reporting attorney will then have no obligation to evaluate the appropriateness of the issuer's response to the report, nor to make any up the ladder reporting. Additionally, a CLO, in lieu of causing an inquiry to be conducted, may direct reports to the QLCC for investigation. In this case, the CLO must report to the reporting attorney that the CLO has referred the report to the QLCC and the QLCC is then responsible for responding to the notification of a material violation.
  - i. The QLCC must be composed of at least one member of the company's audit committee and two or more independent members of the company's board of directors. A QLCC committee must also be responsible for and authorized to conduct any necessary inquiry into the reported violation, to require the company to adopt appropriate remedial measures to prevent an ongoing, or alleviate a past, material violation and to notify the SEC of the material violation if the QLCC decides, by a majority vote, that

the issuer has failed to take any remedial measure that the QLCC has imposed on the issuer. In addition, the QLCC would be required to notify the board, the CLO, and the CEO of the results of any inquiry and the remedial measures deemed appropriate by the QLCC.

ii. Although it may be difficult for companies to recruit individuals to join their QLCC because of the added responsibilities, companies should consider establishing such a committee. Not only does the SEC highly recommend establishing a QLCC, a QLCC will assist the issuer and its employees by having a “central body” within the company to address matters relating to the Rules. In lieu of forming a new committee, a company could expand the responsibilities of its audit committee to encompass those of the QLCC. At a minimum, issuers should consider amending the charter of an otherwise qualifying board committee to allow that committee to constitute itself as a QLCC in the future without further board action. These actions should be taken proactively, since an issuer may not establish a QLCC to respond to a specific incident. Reports may be referred only to a preexisting QLCC.

8. *Disclosure Of Attorney-Client Communications.* The Rules identify several circumstances in which an attorney may, but is not required to, disclose confidential information to the SEC or other applicable court or regulatory agency. Any report or response made under the Rules *may* be used by an attorney in connection with any investigation, proceeding, or litigation in which the attorney’s compliance with the Rules is at issue.
- a. Additionally, a reporting attorney *may* reveal to the SEC, without the issuer’s consent, confidential information to the extent the attorney reasonably believes doing so is necessary to:
- i. Prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interests or property of the issuer or investors;
  - ii. Prevent the issuer from committing perjury or perpetrating a fraud on the SEC; or
  - iii. Rectify the consequences of a material violation by the issuer in the furtherance of which the attorney’s services were used.

- b. Note, however, that there may be a potential issue involving the interplay between the permissible disclosure discussed above, and state ethics rules that permit the disclosure of confidential client information only in certain limited circumstances.

9. *Sanctions.*

- a. *Generally.* The SEC may seek penalties including injunctions, cease and desist orders, and the barring of individuals from serving as officers or directors. Although the adopting release indicates that attorneys who comply in good faith with the Rules will not be subject to discipline for violations of inconsistent standards imposed by a state or other U.S. jurisdiction, a single instance of highly unreasonable conduct or repeated instances of unreasonable conduct that result in violations of the Rules are subject to discipline. This conduct can be on account of either intentional (including reckless) conduct or negligent conduct. In the event of a conflict or inconsistency between the Rules and state law, the Rules will prevail. However, the Rules do not preempt a state's ability to impose more rigorous obligations on attorneys provided such requirements are otherwise consistent with the Rules.
- b. *No Private Right Of Action.* Authority to enforce compliance with the Rules is vested exclusively with the SEC—the Rules do not create a private right of action. Nothing in the Rules, however, expressly precludes private plaintiffs from arguing that the Sarbanes-Oxley Act establishes a standard of care for the purpose of asserting tort claims.

10. *SEC Defers Decision On "Noisy Withdrawal" Requirement.*

- a. *Proposed Rule.* The SEC originally proposed that an attorney who reports evidence of misconduct but does not receive an appropriate response from the company must withdraw from the representation and notify the SEC of his or her withdrawal for "professional considerations." Under those proposals, an attorney would also have to disaffirm any submission to the SEC that is tainted by the violation. In-house counsel would be required to disaffirm any tainted submissions to the SEC, but would not be required to resign. These "noisy withdrawal" procedures would be mandated when the attorney reasonably believes that the reported material violation is ongoing or is about to occur and is likely to result in substantial financial injury to the company or its investors. Additionally, a reporting attorney would be permitted, but not required, to make a "noisy withdrawal"

when the material violation had already occurred and has no ongoing effect but is reasonably believed by the attorney to have caused substantial injury to the financial interest of the company or its investors. The company would also be required to disclose to any successor attorney that the prior attorney withdrew based on professional considerations.

- b. *Objections.* Amid extensive criticism from the legal community claiming that this noisy withdrawal provision would erode client confidence in the attorney-client relationship and potentially violate existing state ethical rules, the SEC deferred action on these aspects of the proposed rules and proposed an alternative withdrawal provision.
- c. *“Company Reporting” Alternative Proposal To Noisy Withdrawal.* Under the SEC’s Company Reporting alternative proposal, an attorney who has reported evidence of a material violation and has not received an appropriate and timely response, would be required to withdraw from representing the issuer and notify the issuer, in writing, that the withdrawal is based on professional considerations. The issuer would then be required to report the attorney’s notice and the related circumstances to the SEC on Form 8-K within two business days. If the issuer fails to comply with these requirements, the attorney would be permitted to inform the SEC of his or her resignation and the surrounding circumstances.

11. *Open Issues And Risk Areas.*

- a. *Withdrawal Obligations.* The SEC solicited public comments to the Noisy Withdrawal proposal and the Company Reporting alternative proposal. The public comment period ended on April 7, 2003. The SEC has not, however, issued final rules on the subject, nor has it publicly abandoned its two withdrawal proposals.
  - i. Shortly after the SEC issued the proposals, the Loss Prevention Journal published by the Attorneys’ Liability Assurance Society, Inc. (“ALAS”) noted that neither proposal appears to limit the lawyer’s withdrawal obligation to the representation giving rise to possible securities law violation or even to all representations involving the SEC. One reading of the proposals suggests that a lawyer would be required to withdraw from all representations of the issuer—even when those representations are entirely unrelated to securities laws or the SEC.

ii. On April 2, 2003, the American Bar Association submitted its comments to the SEC. The ABA objected to both the Noisy Withdrawal and Company Reporting Alternative, expressing its preference for a continuation of *permissive* withdrawal. The ABA viewed the Noisy Withdrawal proposal as conflicting with state professional conduct rules mandating confidentiality and as increasing attorneys' exposure to civil liability. The ABA viewed the Company Reporting Alternative as problematic because it would interfere with the attorney-client relationship, scale back the attorney-client privilege, and unintentionally harm companies and their investors by provoking disclosure of withdrawal that was unwarranted.

iii. On February 4, 2004, the U.S. House of Representatives' Subcommittee on Capital Markets, Insurance and Government conducted a hearing entitled "The Role of Attorneys in Corporate Governance" at which testimony about the SEC's Noisy Withdrawal proposal and Alternative Proposal was heard. In a statement distributed at the hearing, Financial Services Committee Chairman Michael Oxley (R-Ohio) noted that, although the SEC's "up-the-ladder" internal reporting rule was expressly mandated by the Sarbanes-Oxley Act, the Noisy Withdrawal proposal went beyond congressional intent. With respect to the Alternative Proposal, Chairman Oxley acknowledged that it was a scaled-back version of the Noisy Withdrawal proposal. Those who testified echoed many of the concerns raised by lawyers and bar associations during the SEC's review-and-comment period (e.g., both proposals have the potential to erode the attorney-client relationship, turn attorneys into whistleblowers, and encourage lawyers to withdraw prematurely rather than continue to counsel legal compliance regarding difficult issues). At least one witness recommended that "up the ladder" reporting rules, and the newly-revised ABA Model Rule 1.6 (confidentiality) and Model Rule 1.13 (representing organizations) should be given time to work before "reporting out" and withdrawal proposals are mandated.

b. *Lawyer's Duty To Investigate Potential Material Violations And A Company's Responses To Them.* Although the Rules impose no express duty on attorneys to investigate evidence of material violations, certain aspects of the Rules imply that attorneys must undertake some level of investigation.

i. For example, under the Rules, attorneys have a duty to report "evidence of a material violation." The Rules define "evidence of a material violation" to include an objective standard. Under the objective standard,

an attorney cannot avoid his or her reporting obligations by arguing that he or she did not “know” that a violation has occurred. Instead, the attorney must show that a “competent and prudent” attorney would have determined that no violation occurred, which suggests that the attorney must conduct some minimal level of evaluation to determine that no violation occurred. The Rules do not identify the types of information on which attorneys may rely—for example, client representations—in undertaking such an evaluation.

- ii. Similarly, the Rules do not clearly explain an attorney’s responsibility in evaluating a corporation’s response to a reported material violation. The Rules define an “appropriate response” to a reported violation, but they also require an attorney to determine the “reasonableness” of that response. The Rules do not identify the types of information on which an attorney may rely in assessing the corporation’s response. In particular, it is unclear whether an attorney may rely upon the corporation’s representations or must undertake his own investigation. Furthermore, because the Rules permit the SEC to second-guess an attorney’s determination that a corporation’s response was reasonable, the Rules have the practical effect of compelling attorneys to document the basis for their determinations so they can defend themselves later.
- c. *Potential Conflicts Of Interest Regarding The Appointment Of QLCCs.* As an alternative-reporting scheme, the Rules permit issuers to establish QLCCs to receive reports of material violations directly from outside counsel, from the CLO, or other sources. Potential conflicts of interest may arise, however, in advising an issuer whether to use a QLCC or the CLO to receive reports. Often an issuer’s CLO and its regular outside securities counsel may have their own interests in the compliance and reporting procedures that the issuer adopts and providing legal advice on those procedures may involve conflicts of interest. At a minimum, counsel must disclose potential conflicts of interest to the issuer and obtain the issuer’s consent. A more conservative approach would be to recommend that the issuer seek independent counsel on whether to consent to the conflict and on whether to adopt the CLO or QLCC reporting scheme.
- d. *Who Should Make The Calls Under Sarbanes-Oxley?* In light of the economic and other pressures on lawyers who have the primary responsibility for a firm’s relationship with an issuer/client, those lawyers may have difficulty making objective and dispassionate decisions about the client’s con-

duct—even with the best of intentions. Plaintiffs' lawyers may later claim that the lawyer was unduly influenced by his or her relationship with the client and the personal economic stake in that relationship. To minimize this risk, it is sometimes advisable to include other attorneys, who lack a preexisting relationship with the issuer clients, in evaluating reporting obligations under Sarbanes-Oxley.

12. *ABA's August 2003 Amendments To Model Rules 1.6 And 1.13.* Consistent with the post-Enron accountability evaluations that many American corporations undertook, in 2002 the ABA appointed a Task Force to examine possible revisions to the ABA Model Rules of Professional Conduct ("ABA Model Rules"). In August 2003, the ABA's House of Delegates approved amendments to Model Rules 1.6 and 1.13.
  - a. *Amendments To ABA Model Rule 1.6.* In August 2003, the ABA adopted two Task Force recommendations regarding Model Rule 1.6. First, the ABA voted to permit lawyers to reveal confidential information relating to the representation necessary to prevent the client from committing a crime or fraud "reasonably certain" to result in "substantial injury to the financial interests or property of another" (if the client "has used or is using the lawyer's services" in furtherance of the crime or fraud). Second, the ABA voted to allow lawyers to make necessary disclosures about past crimes or frauds, and the ABA voted to allow lawyers to make the same discretionary disclosure to "prevent, mitigate or rectify substantial injury to the financial interests or property of another."
  - b. *Amendment To ABA Model Rule 1.13.* Section 307 of Sarbanes-Oxley should sound familiar to lawyers. The concept of reporting corporate wrongdoing up the hierarchical chain has been part of the ABA Model Rules for many years.
    - i. Under the long-standing version of Model Rule 1.13, lawyers were required to take some action if:
      - (1) They "knew" of any action by company employees that violated the employees' legal obligation to the corporation or was a "violation of law" that could be imputed to the corporation;
      - (2) The matter was related to the lawyer's representation; and
      - (3) The action by the company's employees could subject the company to "substantial injury."

ii. When deciding how to proceed, lawyers have had to consider a number of factors listed in the Rule. Model Rule 1.13 offered suggested courses of conduct, including reporting up the corporate ladder all the way to the board of directors (if necessary). The lawyer “may” resign if the corporation’s “highest authority” insisted upon action (or “a refusal to act”) that is “clearly” a legal violation and is likely to result in “substantial injury” to the company. Model Rule 1.13(c). The August 2003 amendment allows (but does not require) a lawyer to reveal violations *outside* the company if the lawyer believes the violation is “reasonably certain to result in substantial injury to the organization.” Model Rule 1.13 (b), (c). The amendment to Rule 1.13 also reiterates that lawyers *must* take some action upon learning of reportable wrongdoing. The ABA Task Force’s recommendations that corporations adopt policies in which general counsel periodically meet with independent board members to discuss possible corporate wrongdoing, and that outside counsel should likewise establish a direct line of communication with the general counsel to discuss possible corporate wrongdoing, were also adopted.

13. *Interplay Of SEC’s New Rules With State Professional Conduct Codes.* In July 2003, shortly before the effective date of the SEC’s regulations implementing section 307 of the Sarbanes-Oxley Act, the State of Washington’s Bar endeavored to square section 1.06 of the State of Washington’s Rules of Professional Conduct, which permits an attorney to disclose a client’s confidential information only “to the extent the lawyer reasonably believes necessary...[t]o prevent the client from committing a crime,” with the SEC’s reporting out rule, which permits an attorney to disclose a client’s confidential information in situations not authorized by Washington’s rule. A committee of Washington’s State Bar considered the issue and concluded that, to the extent that the SEC Regulations authorize but do not require revelation of client confidences and secrets under certain circumstances, a Washington lawyer should not reveal such confidences and secrets unless authorized to do so. The SEC’s general counsel took the position that Washington’s proposed rules of professional conduct, which prohibited certain disclosures permitted by the SEC’s new rules, were superseded by the SEC rules. According to the letter, the SEC rules control over conflicting state ethics rules with respect to matters covered by the SEC regulations. In response, the Washington Bar informed the SEC that because the SEC rules permitted but did not require attorneys to disclose client confidences, Washington’s more restrictive rules prohibiting disclosures did not create a conflict with the SEC rules.

### C. Deciding Whether To Conduct An Internal Investigation—The Benefits And Risks

#### 1. *Benefits Of Prompt And Thorough Internal Investigations.*

- a. *Evaluating Potential Liability.* An internal investigation assists the corporation in determining the extent of potential criminal or civil liability to enable the corporation to make fully informed decisions for mitigating potential exposure.
- b. *Gaining Control.* If a corporation effectively investigates its own misconduct, the corporation may persuade the government to forgo conducting a separate investigation, reduce the scope of its investigation, or allow the corporation to guide the government's investigation. The government may also agree that if the results of its own investigation conform with the results identified by the corporation, the penalty will be no more than a specified sanction. Thus, a credible internal investigation can prevent a wide-ranging government investigation into the corporation's affairs and give the corporation more control over the nature and focus of the government investigation.
- c. *Minimizing Criminal Exposure.* The best means to avoid indictment is to have full knowledge of all of the relevant facts so that an appropriate pre-indictment defense may be presented to the government. A thorough investigation, combined with voluntary disclosure, may be the determinative factor in convincing the government not to bring criminal charges. Self-reporting and timely cooperation will reduce the culpability score and financial exposure under the Federal Sentencing Guidelines ("Sentencing Guidelines").
  - i. The Sentencing Guidelines were enacted in 1991 and they were highly influential in defining the parameters and content of corporate compliance programs. The 1991 Sentencing Guidelines provided significant benefits at sentencing for a company that had instituted effective compliance programs and/or cooperated with the government by performing the appropriate internal investigation. The United States Sentencing Commission recently proposed amendments to the guidelines to strengthen the provisions describing the nature of an effective compliance program.
  - ii. On October 7, 2003, the United States Sentencing Commission's Ad Hoc Advisory Group on the Organizational Guidelines Report recom-

mended the first significant overhaul of the Sentencing Guidelines for Organizational Offenders since their initial promulgation in November 1991. Under the Group's recommendations, more emphasis would be placed on the criteria for assessing whether an organizational offender has in place an "effective program to prevent and detect violations of law," which provides significant benefits at sentencing. The report emphasizes the importance of: an organizational culture that encourages a commitment to compliance; compliance responsibilities of an organization's governing authority and organizational leadership; making adequate resources available to, and giving adequate authority to, individuals responsible for implementing a compliance program; periodic evaluations of the effectiveness of the compliance program; a mechanism for anonymous reporting of compliance issues; and periodic reviews of compliance risks raised by the activities of the organization, which should then influence the features of the compliance program.

- iii. In the First Year Report prepared by the federal government's Corporate Fraud Task Force, the Task Force emphasized the importance of corporate cooperation in government investigations with a description of the Homestore.com case in which four executives of the largest Internet-based provider of real estate listings pled guilty to securities fraud. The executives simultaneously were sued by the SEC. Homestore.com, however, avoided criminal charges and an SEC enforcement action because the new management agreed immediately to report possible misconduct to the SEC as soon as the Homestore.com's audit committee learned of it, conducted an independent internal investigation and shared the results with the government, did not assert applicable privileges, and terminated responsible wrongdoers.
- d. *Minimizing Civil Exposure.* In some circumstances, there may be a legal duty to investigate misconduct. Management's fiduciary duties to the corporation may include the duty to initiate an investigation when there are indications of misconduct, and failure to investigate could subject management to civil liability. The Sarbanes-Oxley Act of 2002 specifies such duties in the context of attorneys representing issuers. *See also Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986) ("Where suspicions are aroused, or should be aroused, it is the directors' duty to make necessary inquiries."); *see generally* William A. Knepper & Dan A. Bailey, *Liability Of Corporate Officers And Directors* (Matthew Bender, 7th ed. 2002). In-house and outside counsel may also have obligations to investigate and report misconduct.

- e. Recently, in a complaint filed in a whistleblower suit in which the government intervened as a plaintiff, the federal government for the first time alleged that a defendant acted “knowingly” because it failed to maintain an effective compliance plan. *United States v. Merck-Medco Managed Care, L.L.C.*, No. 00-CV-737 (E.D. Pa. filed Sept. 29, 2003). The False Claims Act imposes civil penalties on anyone who “knowingly present[s]” false claims to the United States, which includes conduct taken in “reckless disregard” or “deliberate ignorance” of the information’s truth or falsity. In its amended complaint, the U.S. alleged that defendants engaged in a wide range of misconduct and that senior officials were aware of the misconduct. Significantly, the government asserted that reckless disregard or deliberate ignorance is established by the failure of the defendants to maintain an effective compliance program—including failure to ensure that information and reporting systems existed that were reasonably designed to allow management and the board to reach informed judgments about compliance; failure to make employees aware of the existence or details of the compliance program; failure to assign to specific high-level personnel direct responsibility for overseeing compliance; and failure to employ a compliance officer with responsibility for independently investigating and acting on compliance matters. The district court found these allegations sufficient to survive a motion to dismiss. *Merck-Medco Managed Care, L.L.C.*, No. 00-CV-737, 2004 WL 2137355 (E.D. Pa. Sept. 23, 2004).
- f. *Minimizing Adverse Regulatory Action.* Numerous government agencies have stressed the importance of corporations maintaining effective compliance programs and voluntarily disclosing misconduct. For instance, the OIG has been a leader in defining what constitutes an effective compliance program. To date, the OIG has issued 11 guidance documents for various sectors of the health care industry, which specify in detail the topics that should be addressed in internal compliance programs. *See, e.g.*, OIG Compliance Program Guidance for Pharmaceutical Companies, 68 Fed. Reg. 23,731 (2003); OIG Compliance Program for Ambulance Suppliers, 68 Fed. Reg. 14,245 (2003); OIG Compliance Program for Individual and Small Group Physician Practices, 65 Fed. Reg. 59,434 (2000). The OIG has also promulgated a self-disclosure protocol specifying procedures for reporting suspected fraud. In a notice published in the Federal Register on September 5, 2003, citing the paramount importance to biomedical research to public health efforts, the OIG announced that it would be soliciting input for its next guidance document, which will pertain to recipients

of research grants from the National Institutes of Health. *See* 68 Fed. Reg. 52,783 (2003). The OIG already identified as risk areas to be addressed: the proper allocation of charges to grant projects, accuracy in reporting time and effort by researchers, and reporting use of program funds.

i. Recent actions by the NASD and the SEC continue the trend of increasing the obligations imposed on companies to institute effective compliance policies. On December 2, 2003, the NASD announced that its board of governors had approved and filed with the SEC a proposed rule change that would require the CEO and CCO of each securities firm to jointly certify annually that the firm has processes in place to establish and maintain policies and procedures that will ensure compliance with applicable NASD rules, MSRB rules, and the federal securities laws. [http://www.nasdr.com/news/pr2003/release\\_03\\_055.html](http://www.nasdr.com/news/pr2003/release_03_055.html).

ii. On December 17, 2003, the SEC issued a final rule for Compliance Programs of Investment Companies and Investment Advisors, effective February 5, 2004, that requires each investment company and investment adviser registered with the SEC to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the policies and procedures who, in the case of an investment company, will report directly to the fund board. 17 C.F.R. §§270, 275 (2004).

g. *Public Relations.* A corporation can use an internal investigation to minimize the effect of any negative publicity that has arisen from allegations of wrongdoing. The investigation distances the corporation from any wrongful acts by its employees, and the very fact that an investigation has been launched demonstrates the corporation's good faith and may help restore or maintain investors' confidence.

2. *Associated Risks Of Internal Investigations.* Internal investigations are not without their costs and risks, although these often are substantially outweighed by the benefits. The costs and risks should be identified at the outset, and steps should be taken to minimize them when possible without compromising the investigation.

a. *Risk Of Prosecution.* Disclosure of investigative findings may subject the company, officers, or employees to criminal liability or civil sanctions that otherwise would not arise.

- b. *Difficulty Preserving Confidentiality.* It is increasingly likely that the results of an investigation will be disclosed to the government, potential plaintiffs, or the public. Plaintiffs may be able to use the resulting report as a guide to litigation and as evidence of wrongdoing.
- i. Federal law enforcement and regulatory agencies increasingly demand disclosure of the results of internal investigations, including privileged materials, in settlement negotiations with corporations. The risk of voluntary disclosure to the government is public disclosure.
- ii. Waiving the privilege by self-reporting does have serious risks.
- (1) The corporation may be dissuaded from voluntarily waiving the privilege given the prospect of facing an argument in subsequent or parallel litigation that a privilege has been waived as to other parties.
- (a) Disclosure to third parties generally waives the privilege. This may become an important issue in the context of internal investigations. The corporation is likely to be faced with an argument that its disclosure to one party has waived any privilege over confidential materials generated or gathered during the investigation. *See, e.g., In Re Columbia/HCA Healthcare Corp. Billing Practices Litigation*, 293 F.3d 289 (6th Cir. 2002) (corporation likely waived the attorney-client privilege with respect to third parties when it voluntarily waived its attorney-client privilege in order to make disclosures requested by government); *Westinghouse Elec. Corp. v. Republic of Philippines*, 951 F.2d 1414 (3rd Cir. 1991) (voluntary disclosures to agencies investigating companies waived attorney-client privilege despite argument that companies reasonably expected SEC and DOJ would maintain confidentiality of information disclosed to them, and companies' voluntary disclosures to the SEC and DOJ waived work-product doctrine as against all other adversaries); *United States v. Bergonzi*, 216 F.R.D. 487, 493 (N.D. Cal. 2003) (corporation's outside counsel conducted internal investigation of accounting irregularities and agreed in advance to share investigative memoranda with SEC and federal prosecutor's office, each of which agreed to keep materials confidential. On motion to compel filed by indicted former executives, over objection of the corporation and government, the court found that attorney-client privilege did not apply

because the investigation was never intended to be confidential in light of the corporation's advance agreement to disclose the materials to agencies, and the work product privilege was waived by disclosure to agencies). *But see Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir.1977) (finding that Diversified's disclosure of documents in a nonpublic SEC investigation did not constitute a full waiver of the privilege because holding otherwise "may have the effect of thwarting the developing procedure of corporation to employ independent outside counsel to investigate and advise them in order to protect stockholders, potential stockholders and customers").

(b) Note that the scope of the waiver may be limited. In *In re Grand Jury Proceedings (John Doe Co. v. United States*, 350 F.3d 299 (2d Cir. 2003) and *XYZ Corp. v. United States*, 348 F.3d 16 (1st Cir. 2003), courts sustained claims of "partial" waiver, holding that the waiver effected by the disclosure of privileged information to government investigators is limited to the contents of the disclosure itself, and extends no further.

(2) Although confidentiality agreements are not binding on third parties, they may strengthen an argument for limited waiver.

(a) Courts have not developed a uniform approach concerning the effect of confidentiality agreements.

(b) Confidentiality agreements typically provide that the government will not contend that a company's production of an investigative report, its underlying documents, and related information constitute a waiver of the attorney-client privilege or a waiver of work-product immunity. They further provide that the government will treat as confidential information so designated by the company.

(c) If a confidentiality agreement cannot be obtained, a party disclosing compliance materials may wish to expressly reserve applicable privileges. Although such a reservation may not have any legal effect, some courts may find it persuasive.

(3) *Involuntary Disclosure*. An involuntary disclosure generally does not operate as a waiver. For instance, when disclosure of confidential

information to an opponent is compelled by a court, the disclosure does not waive the privilege with respect to third parties.

(a) The same may be true where a government agency obtains confidential materials under a court-enforced subpoena.

(b) Although disclosure of information to the government under a "voluntary disclosure" program has coercive elements, the courts addressing limited waivers have implicitly rejected the notion that such disclosure is not a waiver because it is involuntary.

iii. *Corporation's Loss Of Control.* Depending on the pressure exerted by the public or prosecutors on the company, disclosure may cause the corporation to lose control of the focus or the pace of the investigation.

3. *Effect Of Internal Investigations On Government Agency Actions And Investigations.*

a. *What is the DOJ's stance on prosecuting corporations?*

i. *New DOJ Guidelines On Indicting Corporations.* On January 20, 2003, the DOJ released a revised set of guidelines on the prosecution of business organizations. The full text of the revised guidelines may be found at: [www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm). A cover memorandum from Deputy Attorney General Larry D. Thompson explained that "the main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation." Too often, the memo noted, corporations only pretend to cooperate, while they "in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation." The new guidelines identify several factors that prosecutors should consider in evaluating "the proper treatment of a corporate target" including the nature of the offense, a corporation's history of similar conduct, the existence and adequacy of a corporation's compliance program, and a corporation's timely and voluntary disclosure of wrongdoing.

(1) *Cooperation And Voluntary Disclosure Of Wrongdoing.* In particular, the revised set of guidelines clearly reinforce the policy that a corporation's "timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents including, if nec-

essary, the waiver of corporate attorney-client and work product protection," will be a factor in the decision to prosecute. In gauging the extent of a corporation's cooperation, the DOJ invites prosecutors to consider "the corporation's willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection."

(2) *Waiver Of Privileges.*

(a) *"Completeness."* The new guidelines specify that prosecutors may assess a corporation's cooperation by the completeness of its disclosure, including its "waiver of the attorney-client privilege and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors and employees and counsel."

(b) *Purpose.* The DOJ offers two reasons in support of waivers: waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without the need to negotiate individual cooperation or immunity agreements; and waivers are "often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation."

(c) *Limits Of The Waiver.* The guidelines note that prosecutors may "request a waiver in appropriate circumstances," but also advise that such a waiver "should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue" and that except in unusual circumstances, "prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation."

(d) *Not An "Absolute Requirement."* The guidelines emphasize that the waiver of a corporation's attorney-client and work-product privileges is not an "absolute requirement" and is only "one factor" in evaluating a corporation's cooperation.

(3) *Protecting Culpable Employees.* The DOJ guidelines identify another related factor in evaluating a corporation's cooperation—whether the corporation appears to be protecting its culpable employees and agents. A corporation's promise of support to culpable employees, through advancing attorneys' fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation under a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.

(4) *Cooperation Only One Relevant Factor.* The guidelines emphasize that a corporation's cooperation is merely one relevant factor in the prosecution decision. The DOJ cautions that a corporation's cooperation "does not automatically entitle it to immunity from prosecution" because a corporation "should not be able to escape liability merely by offering up its directors, officers, employees, or agents as in lieu of its own prosecution." The other factors, that prosecutors are instructed to consider when deciding whether to conduct an investigation, bring charges, and/or negotiate plea agreements include:

- (a) The pervasiveness of wrongdoing within the corporation, including the complicity in, or condoning of, the wrongdoing by corporate management;
- (b) The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;
- (c) Collateral consequences, including disproportionate harm to shareholders, pension holders, and employees not proven personally culpable and the effect on the public arising from the prosecution;
- (d) The adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- (e) The adequacy of remedies such as civil or regulatory enforcement actions.

ii. *Implications Of The DOJ's Stance On Prosecuting Corporations.* Counsel begins an investigation with the knowledge that the fruits of that investigation stand a substantial chance of being disclosed to the government. As a result, counsel and employees must consider that the questions asked, the answers received, and the advice rendered may soon be in the hands of prosecutors, competitors, and civil litigants. This possibility has the effect of chilling inquiry from the outset and often has an adverse effect on the relationships among senior management and lower-level employees. In some cases, it may result in an investigative file that reflects less than the complete picture.

(1) The timing of the privilege waiver may also adversely affect the quality of a corporation's legal advice. By waiving privileges prematurely, the corporate client may be deprived of legal advice based on counsel's full development of facts and an assessment of the strengths and weaknesses of the government's case.

(2) This "new leverage" may also allow the government to circumvent the privilege against self-incrimination of the corporation's employees. During the course of an investigation, the corporation may find itself more closely aligned in interest to the government than its own employees. Similarly, the employees must decide whether to cooperate with the investigation or face possible termination.

(3) Corporate counsel may become more like a government agent. Under certain circumstances, a prosecutor will defer to corporate counsel to interview or seek testimony from corporate employees. Even if there is no express agreement in advance of the interview that counsel will disclose the results to the prosecutor, there is a strong likelihood that this will occur.

b. *The SEC's Stance On Prosecuting Corporations.*

i. *The Seaboard Release.* In October 2001, the SEC issued a section 21(a) report arising from its investigation of Seaboard Corporation. The report is significant in that it details 13 specific criteria that the SEC said it will consider "in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation—from the extraordinary step of taking no enforcement action to bring reduced charges, seeking lighter sanctions, or including mitigating language in documents [the SEC] use[s]"

to announce and resolve enforcement actions." The criteria include the following considerations:

- (1) The nature of the conduct at issue;
- (2) The atmosphere at the issuer company at the time that the alleged wrongful conduct occurred, including the role, if any, of senior management in the conduct;
- (3) The duration of the alleged misconduct and its effect on investors;
- (4) The issuer company's response to the misconduct when it was discovered; and
- (5) The company's cooperation with the SEC in the investigation process.

ii. *Voluntary Waiver Of Privileges.* In the section 21(a) report, the SEC also set forth several factors relevant to analysis of a company's cooperation, including the company's voluntary waiver of the attorney-client and work product privileges. In footnote 3 to the report, the SEC acknowledges that the attorney-client and work product protections "serve important social interests." In that context, the SEC said it does not view a company's waiver of those protections as an end in itself, but rather "as a means (where necessary) to provide relevant and sometimes critical information to the Commission staff." The SEC also noted that, in certain circumstances, it does not consider the voluntary production of privileged information to constitute a subject matter waiver that would entitle the SEC to receive further privileged information.

- (1) The SEC appears to support limiting the waiver of the work product privilege when parties disclose confidential documents prepared by counsel. In *McKesson HBOC, Inc. v. Superior Court*, 115 Cal. App. 4th 1229, 9 Cal. Rptr. 3d 812 (Cal. App. 1 Dist. 2004), the SEC filed a brief in support of the corporation's efforts to maintain the work product privilege over an audit committee report and interview memoranda prepared by outside counsel during an internal investigation. The SEC argued that allowing parties to provide protected documents to the SEC without waiving the work product privileged served the public interest by enhancing the SEC's ability to conduct

investigations more effective and expeditiously. The court, however, concluded that despite confidentiality agreements between the corporation and government stating the corporation's intent not to waive privilege, the corporation's disclosure to the government resulted in a waiver of the attorney-client and work product privilege. Additionally, the SEC has backed legislation—the Securities Fraud Deterrence and Investor Restitution Act of 2003 (H.R. 2179, 108th Cong. (2003))—that will allow the SEC to accept privileged materials from parties without causing such parties to waive the privileged status of such items. SEC officials have stated that the SEC's current inability to obtain otherwise privileged material slows down investigations and often requires it to take duplicative testimony.

#### **D. Conducting Internal Investigations—Best Practices**

1. *Timing.* Timing is important in the initiation of an internal investigation. Make the decision on whether to launch an investigation as soon as there is any substantial or credible evidence of wrongdoing. An early investigation gives the corporation more time to develop appropriate responses or defenses, reduces the likelihood of a qui tam lawsuit, and makes the corporation appear more responsible. If an investigation is not timely, the corporation may not qualify for credit for full cooperation under the Sentencing Guidelines.
2. *Establishing Guidelines.* Establishing guidelines in advance will enable the corporation to avoid allegations that the corporation proceeded on an inconsistent or capricious basis and will minimize the time and effort spent addressing procedural issues when the need for an investigation becomes apparent. The guidelines may cover when an investigation will be conducted and how the investigation will proceed. They may also cover who will determine the need for an investigation and who will oversee the investigation. Particularly in large-scale investigations, however, it may be advisable for counsel to prepare a set of guidelines for a specific investigation to ensure the integrity and confidentiality of the investigation.
3. *Inside vs. Outside Counsel.* Counsel will often have the primary role in overseeing the investigation. This will maximize confidentiality through the availability of the attorney-client and work-product privileges. When the misconduct involved is not substantial, the investigation may be conducted by in-house counsel. In more significant cases, it is best for the investigation to be conducted or overseen by outside counsel, particularly when

in-house counsel may be a witness or when senior management is implicated. In-house counsel bring familiarity with the company and its programs and thus are more readily accepted by employees. Outside counsel may bring greater objectivity and credibility on account of their relative lack of familiarity with the company and their reduced self-interest in validating the conduct. In addition, outside counsel may have a greater ability to achieve confidentiality because there is a reduced risk that communications will be perceived as involving business rather than legal advice.

4. *Witness Interviews.* Although the precise information provided to the employee will vary according to the nature of the investigation, employees should generally be told the things listed below. In a large-scale investigation in which several attorneys are involved and in which middle- or lower-level employees will be interviewed, it may be advisable to provide employees with a written memorandum from counsel or a letter from an appropriate high-ranking corporate official setting forth these items.
  - a. Counsel represents the corporation solely (and not the employee) and is conducting an investigation for the sole purpose of formulating legal advice for the corporation and preparing for anticipated litigation. *See, e.g.,* ABA Model Rules Of Prof'l Conduct R. 1.13(d), 4.3. *United States v. Otterbein*, No. 01-10350-DPW (D. Mass. Oct. 23, 2003), is one of the few decisions addressing how this requirement is applied in practice. A federal magistrate judge concluded that an outside attorney conducting an internal investigation violated ethical conflict-of-interest rules when he did not tell an employee, during internal investigation of the employer's sales and marketing practices, that he was not representing the employee and that the employee's interests diverged from those of his employer. The magistrate judge found that the defendant's statements to the lawyer concerning the legality of his conduct should have prompted the lawyer to advise the defendant that his interests were adverse to those of his employer. The statement, therefore, was obtained in violation of ethical rules, and the magistrate judge recommended that the court exercise its discretion to exclude the statement.
  - b. Counsel has determined that it is necessary to talk with the employee to formulate the legal advice and prepare for anticipated litigation.

- i. The employee will be asked about certain matters relevant to the investigation and is expected to cooperate fully and to provide complete and accurate information.
  - ii. The investigation is highly confidential, and the information provided by the employee is confidential and will be kept in confidential files; however, the corporation itself will determine whether to keep the information confidential and may ultimately decide to disclose it.
  - iii. The employee should not disclose confidential information to anyone without the consent of the appropriate official (such as in-house counsel).
- c. Upon completing the disclosures, counsel should answer any questions the employee may have about the interview.
  - d. In some circumstances, it may be best to conduct interviews without advance warning, although they should still be prefaced with the above introductory remarks. Surprise interviews may be necessary when there is a concern that witnesses will alter or destroy evidence or that witnesses will confer with each other in an attempt to make their accounts consistent.
  - e. Counsel should avoid doing anything that might be taken as an attempt to influence the witness's answers. For instance, counsel should avoid characterizing the corporation's position, summarizing the statements of other witnesses, or selectively presenting documents in a way that may distort the facts.
  - f. The interview should center on the specific misconduct at which the investigation is aimed. Transformation of the investigation into a wide-ranging inquisition into all possible areas of misconduct may be counterproductive because it will detract from the focus of the investigation and unnecessarily diminish employee morale.
  - g. The extent to which witness statements and counsel's opinions should be reduced to writing is a decision that should take into account all of the relevant circumstances. An employee should not generally sign an interview statement or transcript unless it has already been determined that the statement will be given to the government and the interviewer does not wish to be a necessary witness for the statement.

5. *Document Review And Retention Policies.* Review relevant documents before employees are interviewed. The documents usually guide counsel's interview strategy by identifying the important witnesses and by focusing the questions during interviews.
  - a. When structuring document review procedures, assume that documents eventually will have to be produced to the government or to an opponent in litigation. Documents should be catalogued to identify their source to avoid duplicative searches, and privileged documents should be identified and segregated.
  - b. Electronic documents pose unique issues and concerns. Upon beginning an internal investigation, determine how the corporation organizes relevant electronic files and identify what information and how frequently that information is saved in back-up cycles. A corporation's normal recycling of electronic information may need to be suspended so that relevant electronic information is not inadvertently destroyed.
  
6. *Interacting With Simultaneous Government Investigations.*
  - a. *Responding To Document Subpoenas.* Employees should be directed to compile documents responsive to subpoenas and deliver them to counsel for delivery to the government. As counsel, actively and closely supervise this process. Employees often do not understand the need for a comprehensive approach to document production. Become familiar with the types of records maintained by the corporation and explore the possible existence of relevant documents not identified by employees. Neglect of this responsibility may lead to the subsequent identification of documents which should have been produced—a circumstance which is at best embarrassing and at worst (if documents were knowingly withheld) grounds for an obstruction of justice charge. *See, e.g., In re Enron Corp. Securities, Derivative & ERISA Litigation*, 235 F. Supp. 2d 549, 684-85, n. 120 (S.D. Tex. 2002) (Arthur Andersen found guilty of obstruction of justice for destroying documents); *United States v. Davis*, 1 F.3d 606 (7th Cir. 1993) (client whose attorney represented to government that documents being produced were all the documents that responded to the subpoena was charged with obstruction of justice when the government learned of the existence of another document it determined was within scope of subpoena).
  - b. *Preparing Employees For Government Interviews.* Government interviews can be very intimidating. Government investigators may initiate contacts at

employees' homes in the evening, to catch the employees relaxed and off-guard. They may tell employees that they need not seek counsel or consult company representatives, and may suggest that if employees have done nothing wrong there is no need to consult counsel.

i. Employees do have legal protections in this context. They need not talk if they do not so wish. They have a right to consult counsel first, and if they tell the government that they are represented by counsel or wish such representation, continued questioning may violate the Sixth Amendment. The government may not instruct them to not discuss relevant matters with the company or its counsel.

ii. In advance of government interviews, inform employees that the government may wish to interview them in connection with an investigation and that the corporation is represented by counsel in that investigation. Tell the employees about any arrangements that the corporation has made for providing independent counsel to employees. The corporation should explain the role of counsel and make clear that decisions concerning consultation with counsel rest with the employees. Finally, tell employees to be truthful during the interview.

iii. Do not tell employees to refuse to speak with government investigators or that they must contact management before any government interview. In large-scale investigations, it may be appropriate to make these communications in writing. This will: minimize the chances of employees being told something inappropriate; ensure that employees retain the substance of the communication; and minimize doubts about what employees were told. It may also be appropriate to distribute similar memoranda to former employees.

7. *Using Experts.* Although it may be helpful to have experts available to assist counsel in reviewing and analyzing documents or preparing for witness interviews, the use of outside experts increases the possibility of involuntary disclosure of sensitive information. Such experts should be retained only when the attorney believes he or she cannot provide adequate representation without the expert's assistance. To minimize the possibility of waiver, take care to ensure that if experts are employed, they are retained by, and are responsible only to, the attorneys conducting the investigation, and this should be readily apparent from the retention agreement and the surround-

ing circumstances. Also take care to avoid the use of experts solely as investigators of the facts.

8. *Representing Employees*. There is an inherent potential for a conflict of interest between the corporation and its employees. Accordingly, counsel performing the investigation should represent the corporation alone. If it is later determined that there is no conflict of interest, the corporation's counsel may be able to represent employees as well during subsequent judicial proceedings.
  - a. *Diverging Interests Of Corporations And Employees*. The corporation has an interest in cooperating with the government to minimize its liability and to reduce possible penalties. Such cooperation may entail disclosure of facts implicating the individuals responsible for the wrongdoing. An individual employee may have an interest in disclosing the employer's conduct or in accepting an immunity offer that could undermine the corporation's case. See *United States v. Talao*, 222 F.3d 1133, 1140 (9th Cir. 2000) ("Once the employee makes known her desire to give truthful information about potential criminal activity she has witnessed, a clear conflict of interest exists between the employee and the corporation."). Employees may also have an incentive to minimize their own culpability by blaming their actions on the instructions or expectations of their superiors or on the corporate environment.
  - b. Once judicial proceedings are underway, if no conflict of interest exists, counsel may represent the corporation and its employees. Model Rules of Prof'l Conduct R. 1.13(e) (1999); *Griva v. Davison*, 637 A.2d 830 (D.C. 1994); see *Niagara-Genesee & Vicinity Carpenters Local 280 v. United Bhd. of Carpenters of Am.*, 859 F. Supp. 65, 69 (W.D.N.Y. 1994) (disqualifying general counsel of labor union from defending labor union's current officers and trustees in suit brought by labor union's former officers and trustees, who named labor union as a plaintiff).
    - i. The conflict issue may lie dormant until future collateral lawsuits arise. For example, in a subsequent lawsuit by an employee against the corporation, counsel may be disqualified from representing the corporation if counsel also represented the employee. See *Montgomery Acad. v. Kohn*, 50 F. Supp. 2d 344, 353 (D.N.J. 1999) (disqualifying employer's counsel, who had learned employee's confidential information during prior implied representation). But see *Nomura Sec. Int'l, Inc. v. Hu*, 240 A.D.2d 249, 251 (N.Y. App. Div. 1997) (allowing counsel to represent an employer in a suit against an

employee despite having once simultaneously represented a former employee); *cf. Columbo v. Puig*, 745 So. 2d 1106, 1108 (Fla. Dist. Ct. App. 1999) (allowing counsel to represent employer in suit against a former employee, despite counsel having interviewed the former employee during the pre-trial investigation).

ii. Once the investigation is complete and litigation arises, the corporation may pay fees for employees to retain separate counsel when permitted under indemnification provisions of applicable state law and the company's governing documents. Because indemnity may not be determined until the facts are known, the company generally must advance fees subject to an employee's obligation of repayment if the employee is ultimately determined ineligible for indemnity.

9. *Preparing The Investigative Report.* At the conclusion of the investigation, a written report often is prepared, addressed to the individual or committee that ordered the internal investigation. The report generally will summarize the circumstances that led to the investigation; detail the investigative steps that were taken; summarize the facts revealed by the investigation; analyze the applicable law; develop the arguments for and against liability, prosecution, or sanctions; identify internal policies, procedures, or practices that led to the events or that could be improved to prevent future violations; and recommend any appropriate remedial actions, such as product recalls or restitution.
  - a. The form of the report will depend on its intended use. For instance, if a primary purpose of the investigation is to convince the government that the corporation is adequately policing itself and that government enforcement action is not warranted, the report should contain considerable factual detail. If such use is not anticipated and there is concern about eventual disclosure to opponents in litigation, less detail may be provided.
  - b. The report should describe facts and circumstances that reflect well on the corporation. Eventual disclosure of the report will then include positive evidence that may influence the government or a court. For example, the report may show how the corporation's compliance program was effective in discovering and addressing the violation.
  - c. In some instances, the written report may be replaced or supplemented by an oral report. For example, if the investigation was initiated with the expectation that its findings would be disclosed to the government, the

investigators may present their conclusions regarding possible liability and their analysis of the law orally rather than in writing.

- d. When criminal prosecution of the corporation is possible, the report should be drafted in accordance with the requirements of the Sentencing Guidelines, which require “disclosure of all pertinent information known to the organization.” §8C2.5 Application Note 12. In particular, a court will examine “whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct.” *Id.*
10. *Disclosure Of The Investigative Report.* If the corporation intends to disclose the report’s conclusions to governmental authorities in an effort to minimize potential liability or sanctions, the disclosure (possibly the concluding portion of the report itself) should be drafted in accordance with any applicable government requirements.
- a. They may include, among other things:
    - i. A description of the improper practice;
    - ii. A description of the source or cause of the practice;
    - iii. Identification of corporate officials or employees who knew of, encouraged, or participated in the practice;
    - iv. An estimate of the dollar effect of the practice on government agencies;
    - v. A description of how the practice was identified, investigated, and documented;
    - vi. A description of efforts to halt the practice and prevent its recurrence; a description of disciplinary action taken against culpable individuals;
    - vii. A list of supporting information, including interview reports, audits, and audit working papers; and
    - viii. Assurances of willingness to reimburse the government for damages and to cooperate with government investigative efforts.
  - b. If the investigators make written recommendations concerning remedial steps, the corporation should document its responses to those recommendations. Disregard for suggested remedies may harm the corporation in subsequent negotiations or litigation.