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Current and Emerging Issues regarding Internal Investigations

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INTERNAL INVESTIGATIONS: BEST PRACTICES

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I. Introduction

- A. Overview: Corporate internal investigations frequently follow from the discovery of circumstances which suggest that there may be potential liability or financial misconduct. The inquiry is conducted to determine what happened and whether any action by the organization is necessary.
 - 1. Dozens of companies have conducted internal investigations in recent years. The number of these inquiries had clearly increased in the post-Sarbanes-Oxley Act ("SOX") era.
 - 2. Some advisors however, suggest that business organizations should resist the apparent trend of routinely conducting an investigation. *See, e.g.,* Andrew R. Sorkin, *Questioning an Adviser's Advice*, N.Y. Times, Jan. 8, 2008 (interview of Martin Lipton).
- B. Practices: Since there are no formal rules governing the conduct of an internal investigation, various practices have evolved over time. We will analyze the issues and practices currently in use.
- C. Issues which will be discussed include:
 - 1. The decision to conduct an investigation;
 - 2. The purpose of the inquiry;
 - 3. Special considerations regarding SEC and DOJ related investigations;
 - 4. The structure of the investigation; and
 - 5. Conducting the inquiry.

Based on an analysis of these points we will conclude with an overview of key issues and practices.

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II. The decision to conduct an internal investigation

- A. In some situations, an investigation is mandated by law. In others it may essentially be compelled by circumstances. *See generally*, American College of Trial Lawyers, *Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations*, (Feb. 2008) (“American College of Trial Lawyers, *Recommended Practices*”) at 2; Alexandra Shapiro, *Ethics and Best Practices in Internal Investigations*. Practising Law Institute, Corporate Law and Practice Course Handbook (Nov. 8-10, 2007) (“Shapiro, *Ethics and Best Practices*”).
- B. Section 10A of the Securities Exchange Act (“Exchange Act”) requires that investigations be conducted under certain circumstances. 15 U.S.C. § 78j-1(b). That section provides in pertinent part:
- “If, in the course of conducting an audit pursuant to this title to which subsection (a) of this section applies, the registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the firm shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission—
- A. (i) determine whether it is likely that an illegal act has occurred; and
(ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and
- B. as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such firm in the course of the audit, unless the illegal act is clearly inconsequential.”
- C. SOX and Reporting Up: The “reporting up” provisions of Sarbanes-Oxley Section 307 require in-house counsel to report certain events up through the organization. More controversial proposals regarding the disclosure of confidential information have either never been adopted or were dropped. 17 C.F.R. §205.3 (2003); *see also* C. Even Stewart, *The Pit and the Pendulum, and the Legal Profession: Where Do We Start After Five Years of Sarbanes-Oxley?*, 40 Sec. Reg. & L.R. 247. This reporting up process

can place the company in a position where it may be virtually compelled to self-report.

- D. SOX also can create compulsion. The Act imposes a number of obligations on companies and management. For example, Sections 302 and 906 essentially require the CEO and CFO to certify the information in the periodic filings of the company. These and other obligations under SOX, virtually compels the company to self report any malfeasance. See, e.g. Thomas O. Gorman and Heather J. Stewart, *Is There a New Sheriff in Corporateville? The Obligations of Directors, Officers and Lawyers After Sarbanes-Oxley of 2002*, 56 Admin. L. Rev. 135 (2004); Robert S. Bennett, Alan Kregel, Carl S. Rauch and Charles F. Walker, *Internal Investigations at the Defense of Corporations in the Sarbanes-Oxley Rev.*, 62 Bus. Law 55 (Nov. 2006) (“whenever a company has reason to believe that a problem may have occurred, it should investigate internally . . . Although the company may pause to ask whether it really wants to know what happened, the answer is that it can not afford not to know, particularly given the certification obligations . . .” under SOX). To effectively self-report, the company will have to conduct an investigation and determine the facts. See also Gary Di Bianco and Andrew M. Lawrence, *Investigation and Reporting Obligations under Section 10A of The Securities Exchange Act*, 1 J.Sec. 2 Futures Law, (Feb. 18, 2008). See also, *In re Caremaker International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (discussing the obligations of directors to monitor and their reliance on corporate systems).²
- E. Other circumstances may also effectively require the company to conduct an inquiry and self-report. For example, if the company discovers a material error in its financial statements it may have to restate its published financial statements. See, e.g., SFAS 154, Accounting Changes and Error Corrections. Effectively, this will require the company to self-report to the SEC.
- F. If the Securities and Exchange Commission ("SEC"), Department of Justice ("DOJ"), a state law enforcement organization or a self-regulatory organization such as the New York Stock Exchange commences an investigation, the company may consider conducting an inquiry. Likewise, if the company is named as a defendant in a major suit, it may be necessary to conduct an internal investigation.
- G. A variety of other events may trigger an investigation. For example:
1. Receipt of a whistleblower letter;

² John Hasnos, Department of Coercion, Wall Street Journal, March 11, 2006; (concluding directors have a fiduciary duty to self-report) See also Frank C. Razzano, *To Cooperate With the Securities Exchange Commission or Not to Cooperate – That’s the Question – Part II*, 31 Sec. Reg. L.J. 410 (2003).

2. Receipt of a letter that raises allegations of misconduct;
3. Shareholder demand (through a threatened or actual derivative action), which could result in the formation of a special litigation committee;
4. If an auditor (external or internal) raises allegations of misconduct;
5. If a Board member suspects misconduct by officers or employees; and
6. The media, a watchdog organization or an academic group allege misconduct in a specific industry or by the company.³

III. The Purpose Of The Investigation

- A. The reason for conducting the inquiry and the ultimate use of its findings can have a significant impact on how it is structured. Accordingly, the purpose of the inquiry and the potential use of the results should be determined at the outset.
- B. Self-reporting/cooperation: If the investigation is being conducted to self-report to the SEC, DOJ or some other government entity, then key questions regarding cooperation must be considered at the outset. These questions are considered in the next section. Key issues involve the waiver of privilege, indemnification and cooperation with employees through common interest agreements. The resolution of these issues can have a significant impact on the inquiry.
- C. If the inquiry is not being conducted for reporting to the SEC, DOJ or some other government agency, then that purpose must be considered and evaluated when structuring the examination.

IV. Special Considerations In SEC and DOJ Related Inquiries

- A. Cooperation credit. DOJ and the SEC have issued statements regarding cooperation. Both encourage self-reporting and cooperation. The key issue for companies is what is required to obtain credit in the charging decision process and what is the value of any credit.
- B. Value. A company which chooses to cooperate with the SEC and DOJ by waiving privilege and perhaps limiting its cooperation with and indemnification of employees may suffer collateral injury. Disclosure of

³ See also, Mark D. Pollack and Erin R. Schrantz, *Conducting Internal Investigations After Sarbanes-Oxley*, Best Practices, 14 No. 6 Proc. Litigation 15, 17 (2003) (corporation can use investigations to distance itself from the conduct and the fact it has been launched shows good faith).

privileged material in private actions may be detrimental to the company. The organization may also experience long term employee difficulties by limiting its cooperation with employees. These and other potential issues must be considered along with the prospect and value of potential cooperation credit from the SEC or DOJ. Yet decisions on cooperation typically are made at the beginning of the inquiry. Any cooperation credit which may be given by the SEC or DOJ cannot be evaluated at that point.⁴

1. The key issues here revolve around how the company cooperates with either the SEC or DOJ. The answer to that question typically begins with a complete internal investigation by the company, which is furnished to the SEC and DOJ. In furnishing the results of that inquiry to the SEC and DOJ, questions concerning the waiver of the attorney client privilege and work product protections which apply to portions of the inquiry arise.
2. Additional issues relate to what cooperation (if any) company employees will give to the government. This question can become particularly difficult when the company is paying the legal fees of an employee and sharing information with an individual who then declines to cooperate with the SEC and DOJ.
3. Both the SEC and DOJ have issued statements addressing the question of cooperation and credit in the charging process. All of these statements are vague, ill-defined and offer little concrete guidance. Nevertheless, an evaluation of this issue must be made at the outset of the inquiry.⁵

C. Waiver of the Attorney Client and Work Product Privileges: An organization is likely to be asked whether it will make privileged information gathered during the internal investigation available to the government.

1. DOJ and privilege waivers: Its position is set forth in a series of memoranda issued by the then-Deputy Attorney General.
 - a. The Holder Memorandum: In 1999, then-Deputy Attorney General Eric Holder issued the first of what has become a series of memoranda articulating principles to be considered in making a charging decision as to a business

⁴ See also, *NYSE Division of Enforcement Information Memorandum No. 0565* (Sept. 14, 2005) (discusses cooperation noting that prompt full disclosure coupled with a thorough internal review is key to obtaining cooperation credit).

⁵ See also, Sarah Helen Duggin, *Intent Corporate Investigations: Legal Ethics, Professionalism and the Employee Interview*, 2003 Colum. Bus. L. Rev. 859, 952 (2003) (“one major problem [with cooperation policies that call for waiver] is that these kinds of policies invite investigating counsel to bow to the pressure to become participants in a sotto voce effort to obtain incriminating information from corporation constituents without basic procedural protections”).

organization. It includes references to cooperation. Memorandum from Eric Holder, Deputy Attorney General to All Component Heads and United States Attorneys, “Bringing Criminal Charges Against Corporations” (June 16, 1999) (“Holder Memorandum”) (available at <http://www.usdoj.gov/criminal/fraud/docs/reports/1999/bringingcorps.html>).

- i. It listed a series of factors that a prosecutor should consider in reaching a decision as to the proper treatment of a corporate target. One point states: “The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the attorney-client and work product privileges.”
 - ii. In addition, in the memorandum Mr. Holder states: “In gauging the extent of the corporation's cooperation, the prosecutor may 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 the attorney-client and work product privileges.”
 - iii. Prosecutors are instructed to consider “the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors, and employees and counsel. Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements. In addition, they are often critical in enabling the government to evaluate the completeness of a corporation's voluntary disclosure and cooperation. Prosecutors may, therefore, request a waiver in appropriate circumstances.” The memorandum makes it clear however, that privilege waivers are not an absolute requirement.
- b. The Thompson Memorandum. This memorandum, issued on January 23, 2003, by then Deputy Attorney General Larry D. Thompson, revised and expanded the Holder

Memorandum, (available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm)

- i. While the Thompson Memorandum repeated many of the principles in the Holder Memorandum, it was designed to increase “emphasis on and scrutiny of the authenticity of a corporation's cooperation.”
- ii. It noted that “Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution.”
- iii. Prosecutors were directed to weigh “whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.” Prosecutors were required to comply with the Thompson Memorandum, in contrast to the Holder Memorandum, which was voluntary.
- iv. The Thompson Memorandum has been widely criticized for undermining the attorney client privilege and work product doctrine. Some critics charge that the memorandum unnecessarily strips organizations of the key rights and that it has created a culture of waiver in which cooperation is really defined by waiving privilege. *See, e.g.*, National Association of Criminal Defense Lawyers News Release, “Report: Attorney-Client Privilege Disappearing in White Collar Cases” (Mar. 2, 2006), available at <http://www.nacdl.org/public.nsf/newsreleases/2006mn005?OpenDocument>; National Association of

Criminal Defense Lawyers, The Decline Of the Attorney-Client Privilege in the Corporate Context Survey Results, (Mar. 2, 2006), available at [http://www.nacdl.org/public.nsf/whitecollar/wcnews024/\\$FILE/A-C_PrivSurvey.pdf](http://www.nacdl.org/public.nsf/whitecollar/wcnews024/$FILE/A-C_PrivSurvey.pdf). (survey finding most in-house and outside counsel view waiver as mandatory).

- c. The McNulty Memorandum. In 2006, DOJ responded to the criticism by issuing a new directive on corporate cooperation – the McNulty Memorandum. This memorandum altered the overall approach to the question of privilege waivers and imposed limitations on the circumstances under which prosecutors could seek privileged material. Memorandum from Paul J. McNulty, Deputy Attorney General to Head of Department Components and United States Attorneys (“McNulty Memorandum”), available at http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf
 - i. In a marked departure from the skeptical language of the Thompson Memorandum, the McNulty Memorandum acknowledged that “[t]he attorney-client and work product protections serve an extremely important function in the U.S. legal system. The attorney-client privilege is one of the oldest and most sacrosanct privileges under U.S. law ... The work product doctrine also serves similarly important interests.”
 - ii. The memo states that “Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation.” But, it noted that such a waiver “may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure.”
 - iii. Prosecutors can only seek a waiver “when there is a legitimate need for the privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The

test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation.” Establishing a legitimate need now depends upon:

- (a) the likelihood and degree to which the privileged information will benefit the government's investigation;
 - (b) whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;
 - (c) the completeness of the voluntary disclosure already provided; and
 - (d) the collateral consequences to a corporation of a waiver.
- iv. Under this approach “prosecutors should seek the least intrusive waiver necessary to conduct a complete and thorough investigation, and should follow a step-by-step approach to requesting information.”
- (a) Category I – “Prosecutors should first request purely factual information, which may or may not be privileged, relating to the underlying misconduct.” Material in this category is largely factual, such as key documents and witness statements. Before requesting a waiver of privilege as to this material, the prosecutor must obtain authorization from the U.S. Attorney. If the organization declines the request, that fact can be considered in assessing cooperation and the charging process.
 - (b) Category II – Material in this category typically includes attorney notes, legal advice given to the entity and similar information. This information should only be sought in rare instances. Authorization from the Deputy Attorney General must be obtained before seeking a waiver as to the

material in this category. A refusal to waive privilege as to this material cannot be considered in the charging decision.

- (c) Prosecutors are free to accept a voluntary waiver from the organization.

- v. Further criticism. Many critics claim that the McNulty memorandum has had little to no impact. *See, e.g.*, Letter from E. Norman Veasey, former Chief Justice of the Delaware Supreme Court, to Senators Leahy and Specter, dated September 13, 2007. (available at <http://www.acc.com/public/veasey.pdf>) (informal survey showing no change); The U.S. Chamber of Commerce, Report and Recommendations from its independent, bipartisan Commission on the Regulation of U.S. Capital Markets in the 21st Century, March 2007 (full report and executive summary available at <http://www.uschamber.com/publications/reports/0703capmarketscomm.htm>) (the McNulty Memorandum should be revised, no cooperation credit for waivers).

- d. The Attorney-Client Protection Act was passed by the House in November 2007. As of July 2008, it is being considered by the Senate. It would essentially preclude any agency or attorney representing the U.S. from: requesting the disclosure of privileged material; or considering in a charging decision any valid assertions of privilege, indemnification agreements, common interest agreements or the failure to terminate employees because of an exercise of constitutional rights.

- e. July 2008 – DOJ signaled a change to the McNulty Memorandum. On July 9, 2008, Attorney General Michael Mukasey testified before the Senate Judiciary Committee and indicated that the McNulty Memorandum is under revision. A letter from Deputy Attorney General Mark Filip dated July 9, 2008, to Senator Arlen Specter states that DOJ will issue revisions to the existing standards on cooperation shortly. The letter notes that in the future:
 - i. Cooperation will be measured by the extent to which a corporation discloses relevant facts and evidence, not its privilege waivers;

- ii. Federal prosecutors will not demand Category II privileged material as a condition of cooperation credit;
 - iii. The advancement of attorneys fees will not be considered;
 - iv. Entry into joint defense agreements will not be considered; and
 - v. Prosecutors will not consider whether the company has retained or sanctioned employees thought to be culpable.
2. The U.S. Sentencing Commission. In 2004 the Commission stated: “Waiver of attorney-client privilege and of work product protections is not a prerequisite to [reducing culpability] ... Unless such a waiver is necessary to provide timely and thorough disclosure of all pertinent information known to the organization.”
3. The SEC and Privilege. In the October 2001 Seaboard Release (formerly titled “Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions”), the SEC offered the prospect of not bringing an enforcement action, or at least mitigation of any penalty, in exchange for cooperation. The Release discusses the question of privilege issues.
- a. The Release is an Exchange Act Section 21(a) report of an investigation regarding a financial fraud case. In the underlying case, the controller and two others at a subsidiary of a public company falsified the books. The SEC did not bring an action against the company in view of the nature of the fraud and the cooperation of the company.
 - b. The SEC declined prosecution as to the organization “given the nature of the conduct and the company's responses. Within a week of learning about the apparent misconduct, the company's internal auditors had conducted a preliminary review and had advised company management who, in turn, advised the Board's audit committee, that [the former controller] had caused the company's books and records to be inaccurate and its financial reports to be misstated. The full Board was advised and authorized the company to hire an outside law firm to conduct a thorough inquiry. Four days later, [the controller] was dismissed, as were two other employees who, in the company's view, had inadequately supervised [the controller]; a day later, the company disclosed publicly and to [the SEC] that its

financial statements would be restated . . . The company pledged and gave complete cooperation to [the SEC] staff. It provided the staff with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of [the controller] and others; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.”

- c. The Release goes on identify a series of questions that SEC Enforcement attorneys should consider in making a charging decision. These questions are “some of the criteria we 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 bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.” The questions include:
 - i. “Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation?”
 - ii. “Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law?”
 - iii. “Did the company produce a thorough and probing written report detailing the findings of its review?”
 - iv. “Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered?”
 - v. “Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?”
- d. The Release goes on to discuss the Commission’s view on waiving privilege and suggests that in cooperating, issuers may chose not to assert privilege. The statement is followed by a citation to a case in which the SEC filed an amicus brief arguing that turning over privileged material

under a nonwaiver agreement does not affect a waiver as to third parties.⁶

- e. The Release makes it clear that the SEC is not bound by any of the criteria in it and that other unspecified factors may be considered. In sum, the SEC noted, enforcement divisions are made on a case-by-case bases.
- f. Other statements. The SEC insists that privilege waivers are not necessary to obtain cooperation credit. In subsequent statements, the SEC has made it clear how the policy is administered. In the speech, the Director of Enforcement cited two cases in which cooperation credit was given as examples of the Commission's policy. In one example, the company waived privilege and was not charged and in the second, the company did not waive privilege was charged. Linda Thomsen, Speech by SEC Staff: Remarks Before the Mutual Fund Directors Forum 7th Annual Policy Conference (Apr. 12, 2007) (available at <http://www.sec.gov/news/speech/2007/spch041207lct.htm>).⁷

D. Another key issue involves indemnification rights and cooperation agreements for employees. Indemnification may be a standard corporate privilege. If, however, the investigation results may be turned over to the SEC or DOJ, how these questions are handled and resolved can have a significant impact on the outcome of the matter.

1. DOJ and Indemnification.

- a. The 1999 Holder Memorandum discusses indemnification stating:

“Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ

⁶ The SEC has repeatedly suggested that issuers can produce privileged material to it under non-waiver agreements. These agreements stipulate that the production is not a waiver of privilege as to third parties. Most courts have rejected this theory. *In re Qwest Communications Intern., Inc.*, 450 F.3d 1179 (10th Cir. 2006); *In re Columbia/HCA Healthcare Corp.*, 293 F.3d 289 (6th Cir. 2002); *U.S. v. Mass. Inst. Of Tech.*, 129 F.3d 681 (1st Cir. 1997); *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991); *In re Martin Marietta*, 856 F.2d 619 (4th Cir. 1988); *In re Subpoenas Duces Tecum*, 738 F.2d 1367 (D.C. Cir. 1984). *But see Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978)(adopting selective waiver); *Saito v. McKesson HBOC*, No. 18533 2002 Del. Ch. LEXIS 125 (Del. Ch. Oct. 22, 2002) (same). *See also, U.S. v. Reyes*, 2006 U.S. Dist. LEXIS 94457 (N.D. Cal. Dec. 22, 2006) (privilege over an internal investigation waived when investigating counsel provide oral briefings to SEC and DOJ).

⁷ *But see* speech by SEC Commissioner Paul Atkins, *Remarks Before the SEC Speech 2007*, available at <http://www.sec.gov/news/speech/2007/spch20907psa.htm>. (noting that a failure to waive privilege should not impact cooperation credit.)

depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, <http://www.usdoj.gov/criminal/fraud/docs/reports/1999/chargingcorps.html> - N 3 #N 3 through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation. By the same token, the prosecutor should be wary of attempts to shield corporate officers and employees from liability by a willingness of the corporation to plead guilty.”

- b. The Holder Memorandum added in a footnote that “Some states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate.”
- c. The Thompson Memorandum reiterated the statements in the Holder Memorandum – but made it binding on all prosecutors. U.S. Dep’t of Justice, Criminal Resource Manual § 163 (2005)
- d. *U.S. v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) held portions of the Thompson Memorandum to be in violation of the Fifth and Sixth Amendments.
 - i. The factual background. The defendants are former employees of KPMG charged with criminal tax fraud in a shelter case. The accounting firm had a policy of indemnifying employees. KPMG sought to cooperate to avoid prosecution. As part of cooperation, the firm urged employees to cooperate and conditioned indemnification on cooperation, that is, being interviewed in the government's inquiry and not asserting the Fifth Amendment.
 - ii. Judge Kaplan concluded that those portions of the Thompson Memorandum dealing with indemnification rights violated the Fifth and Sixth Amendment rights of the defendants. Indemnification of the KPMG employees was permitted by law and had traditionally been extended to firm employees. In the context of the

case, the court held that the Thompson Memorandum's provisions regarding employee attorney's fees would be considered by the prosecutor in weighing the extent and value of a corporation's cooperation violated the due process of the employees and was a violation of the employees' right to counsel under the Fifth and Sixth Amendment.

- e. The McNulty Memorandum, issued in late 2006, retreated from the harsher views expressed in the Holder and Thompson Memorandum.
 - i. "Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate. This prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees."
 - ii. However, "[i]n extremely rare cases the advancement of attorneys' fees may be taken into account when the totality of the circumstances show that it was intended to impede a criminal investigation. In these cases, fee advancement is considered with many other telling facts to make a determination that the corporation is acting improperly to shield itself and its culpable employees from government scrutiny . . . Where these circumstances exist, approval must be obtained from the Deputy Attorney General before prosecutors may consider this factor in their charging decisions."
 - iii. At the same time, prosecutors were instructed that "[r]outine questions regarding the representation status of a corporation and its employees, including

how and by whom attorneys' fees are paid, frequently arise in the course of an investigation. They may be necessary to assess other issues, such as conflict-of-interest. Such questions are appropriate and this guidance is not intended to prohibit such inquiry.” In *Stein*, the prosecutors testified that they did not instruct KPMG to cut off indemnification for those who invoked the Fifth Amendment. Rather, the prosecutors claimed that they only asked questions about the indemnification rights.⁸

- f. Recent DOJ statement. Sentencing memorandum: In its sentencing memorandum filed in *U.S. v. Bennett*, Case No. 05-cr-1192 (S.D.N.Y. Filed June 16, 2007), the government argued that the former CEO of Refco was not entitled to credit for cooperation with the plaintiffs in the class action suits which came out of the Refco debacle because his attorney fees were paid for under a company indemnification agreement. Mr. Bennett pled guilty to all 20 Counts in the indictment. Subsequently, he was sentenced to 16 years in prison, less than the sentence the government sought.
2. SEC and Indemnification. The SEC's *Seaboard* release does not comment on indemnification rights. It does however, consider whether those deemed culpable are still in the same positions or with the company.
 - a. The SEC's recent statement on Corporate penalties lists a number of factors considered in assessing whether a civil penalty should be assess is the "extent of cooperation with the Commission and other law enforcement agencies." Statement of the Securities and Exchange Commission Concerning Financial Penalties, January 4, 2006, available at www.sec.gov/news/press/2006-4htm.
 - b. In 2003, after Xerox Corporation announced that it would indemnify its employees that settled with the SEC for both their fees and disgorgement, then Chairman William Donaldson publicly rebuked the company stating:

⁸ See also, *Legal Ethics, Professionalism and the Employee Interview*, 2003 Colum. Bus. L. Rev. at 954. (“The only apparent reason for prosecutors to consider fee advancement as a factor in charging, plea negotiations or sentencing position decisions is to make it more difficult for individuals to obtain counsel, or at least to obtain counsel with the resources necessary to function effectively in complex corporate criminal matters.”)

I'm concerned about companies that, under permissive state laws, indemnify their officers and directors against disgorgement and penalties ordered in law enforcement actions, including those brought by the Commission. In my mind, this just isn't good public policy. This is an area in which we may need to consider ways to bring about reform.⁹

- c. Lucent Technologies paid \$25 million fine as part of a consent decree for a lack of cooperation which included expanding those eligible for indemnification during settlement discussions.¹⁰ As former SEC enforcement chief explained:

Where the Commission gets concerned is if a company voluntarily – particularly voluntarily, not pursuant to state law – indemnifies individual employees for penalties or disgorgement remedies that they would otherwise suffer in an SEC or Justice Department action. And I think that should be a concern. ... In fact, it is the most important part of deterrence, making sure that individuals know that if they do wrong, they are going to go to jail or they are going to pay heavy fines. But if they can rely on someone else to pay those fines, what good have we done? What deterrence have we really achieved?¹¹

- E. Common interest agreements. Another key issue involves cooperation with employees and common interest agreements. Under these agreements, the company can share information with the employee in a privileged setting. These agreements are frequently essential to employee who needs access to the company documents to effectively prepare to be interviewed in the inquiry or testify before the SEC. Yet, sharing information can make it appear that the company's claims of cooperation

⁹ Chairman William H. Donaldson, *Speech by SEC Chairman: Remarks Before the New York Financial Writers Association*, June 5, 2003, at <http://sec.gov/news/speech/spch060503whd.htm>. Significant questions have been raised regarding the authority of the SEC to impose sanctions for a lack of cooperation. See U.S. Chamber of Commerce, *Report on the Current Enforcement Program of the Securities and Exchange Commission*, (March 2006) at 30.

¹⁰ SEC Press Release No. 2004-67 (May 17, 2004) (available at <http://www.sec.gov/news/press/2004-67.htm>).

¹¹ See also, Item 702 of Regulation S-K, which requires companies to disclose insurance or indemnification arrangements for its controlling persons, directors and officers.

are disingenuous, particularly when the employee is deemed "culpable" by the government and or refuses to cooperate with the SEC or DOJ.

- F. Deputization. Recently, DOJ has brought obstruction of justice charges against witnesses who made false statements to private counsel conducting an internal corporate investigation when the witness knew that the statements would be given to the government for use in its inquiry.¹²
1. The charges are based on 18 U.S.C. § 1512, which is part of the Sarbanes-Oxley Act. It provides in part: "(c) Whoever corruptly – * * * (2) ... obstructs, influences, or impedes any official proceeding, or attempts to do so, shall be fined under this title or imprisoned not more than 20 years, or both * * * (k) Whoever conspires to commit any offense under this section shall be subject to the same penalties as those proscribed for the offense the commission of which was the object of the conspiracy. *See generally* Julie R. O’Sullivan, “The DOJ Risks Killing the Golden Goose Through Computer Associates/Singleton Theories of Obstruction,” *American Criminal Law Review*, Vol. 44, p. 1447, 2007 (discussing the testing of the SOX amendments).¹³
 2. Indictments have been returned against individuals for making false statements to internal investigators.
 - a. *U.S. v. Kumar*, Cr. No. 04-846, (ILG) (E.D.N.Y. filed Sept. 20, 2004). Here, Sanjay Kumar, former Director and C.O.O. and later C.E.O. of Computer Associates International, Inc., and Stephen Richards, also of Computer Associates, were named as defendants. The indictment alleged that Messrs. Kumar and Richards (and others) engaged in a company-wide practice of falsely and fraudulently recording and reporting certain license agreements before they were completed (calling the practice “the 35-day month” or “the three-day window”) which resulted in the filing of materially false financial statements so that Computer Associates could meet or exceed its projected quarterly income figures.

¹² *See generally* Sarah Helen Duggan, Intel the Corporate Investigations: Legal Ethics, Professionalism and Employee Interview, 2003 *Colum. Bus. L. Rev.* 859 (2003).

¹³ In some cases, the Government has prosecuted individuals for violating 18 U.S.C. § 1512(c)(2) when the defendant forged a document or created a false one. *U.S. v. Reich*, 420 F. Supp. 2d 75, 84 (E.D.N.Y. 2006) (defendant violated § 1512(c)(2) when he created a forged order and sent it to a law firm); *U.S. v. Gladiola Ramirez*, 2006 WL 573971 (D.P.R. Mar. 8, 2006) (defendant violated § 1512(c)(2) when he “drafted a phony services contract to hide the true nature of illegal kickback payments”); *U.S. v. Hutcherson*, 6:05-cr-0039-jct, 2006 WL 270019 (W.D. Va. Feb. 3, 2006) (indictment adequately alleged violation of § 1512(c)(2) where it alleged defendant prepared a phony document).

- i. The Government commenced an investigation in 2002.
- ii. Computer Associates retained a law firm to represent it in connection with the government investigations and publicly stated in press releases and SEC filings that it would cooperate fully with the investigations. The law firm met with and interviewed Messrs. Kumar, Richards and others, who made a series of false statements, including concealing the existence of the 35-day month practice. The Audit Committee retained a second law firm to conduct an internal investigation and Messrs. Kumar and Richards again made a series of false statements.
- iii. Messrs. Kumar and Richards made similar false statements to FBI agents and the SEC. They were indicted for: Conspiring to obstruct justice under 18 U.S.C. § 1512(k); Obstructing justice under 18 U.S.C. §1512(c)(2); and securities fraud, wire fraud, making false SEC filings, perjury and false statements (for the subsequent statements to Government agents).
- iv. The defendants moved to dismiss the obstruction counts on the ground that there was an insufficient "nexus" between their alleged statements to the company's attorneys and an official proceeding.¹⁴ The District Court denied the defendants' motions. *See Order Denying Motion to Dismiss Counts Six and Seven of the Superseding Indictment as to Sanjay Kumar, Stephen Richards, U.S. v. Kumar*, No. 04-cr-846, slip op. (E.D.N.Y. Feb. 21, 2006). While the court appeared to agree with the nexus argument, it concluded that because defendants "knew" about the government inquiry the charges could not be dismissed.
- v. Messrs. Kumar and Richards plead guilty to all charges, including the obstruction and conspiracy to obstruct counts in April 2006. The United States Attorney's Office for the Eastern District of Virginia, Press Release: "Former Computer

¹⁴ *See also, U.S. v. Aguilar*, 515 U.S. 599 (1995) (holding that a nexus must be established between the false statement and the official proceeding)

Associates CEO Sanjay Kumar And Former Head Of World-Wide Sales Stephen Richards Plead Guilty To All Charges Of Securities Fraud And Admit Lying To Federal Investigators To Cover Up The Scheme,” (Apr. 24, 2006) (available at <http://www.usdoj.gov/usao/nye/pr/2006/2006apr24.html>)

- b. *U.S. v. Singleton*, Criminal No. 4:06 CR 0880 (S.D. Tex. Mar. 8, 2006). The indictment named Greg Singleton (a natural gas trader for El Paso Corporation’s Merchant Energy segment). It alleged that Mr. Singleton, along with Michelle Valencia (named as a defendant in a separate action), conspired to transmit false reports concerning market information that affected the price of natural gas (including reporting non-existent gas trades and not reporting other gas trades).
- i. In July 2002, the U.S. Attorney’s Office for the Southern District of Texas began investigating transactions at El Paso Corporation and issued a grand jury subpoena for the production of documents to the company.
 - ii. In October 2002, the Commodity Futures Trading Commission (“CFTC”) issued a subpoena to El Paso Corporation as well. Subsequently, El Paso commenced an internal investigation. Mr. Singleton and his counsel met with El Paso Corporation’s outside counsel. According to the Government, Mr. Singleton made false statements regarding whether he provided false information to trade publications which was turned over to the government.
 - iii. The government indicted Mr. Singleton for obstruction under 18 U.S.C. § 1512(c)(2), as well as conspiracy and reporting violations. Defendant's motion to dismiss was denied. The Court held “that to violate § 1512(c)(2), the charged conduct must have some reasonable nexus to a record, document or tangible object.” Here, “[t]he Indictment alleges in effect that Singleton provided false information that El Paso’s outside lawyers used to create a written report that they submitted to the CFTC, the FERC, and the USAO. These allegations satisfy the requirement for some nexus to a document or other tangible evidence. In substance, the indictment

charges that Singleton knowingly and corruptly participated in the creation of a memorandum – a document or tangible object – that he expected would obstruct, influence or impede the CFTC’s, FERC’s and/or USAO’s investigations.”

iv. At trial, following the Government’s case-in-chief, Mr. Singleton moved for acquittal on the obstruction count citing the testimony of outside counsel who told Mr. Singleton that they would be reporting the results of the investigation to upper management of El Paso Corporation, that upper management of El Paso Corporation would decide whether or not to pass along the results to the Government, but did not tell Mr. Singleton that they were going to prepare a memorandum to the government regarding the interview. The Court granted the Motion for Acquittal.

c. The SEC has included similar allegations in a civil case. *See SEC v. Woghin*, 04 Civ. 4087 (Sept. 22, 2004) (enforcement action against general counsel of Computer Associates which in part alleged obstruction).

V. The Structure of the Investigation

A. The supervising committee. The purpose of the investigation is a key consideration in determining who should oversee and conduct the inquiry. If the investigation is being conducted to self-report to the SEC or DOJ or to evaluate a derivative suit, it is critical that the investigation in fact and appearance be independent. A lack of independence may undermine the credibility of the inquiry and its findings. *See, e.g.*, Speech by Stephen Cutler, Director, Division of Enforcement, *The Thesis of Sarbanes-Oxley as Reflected in the Commission’s Enforcement Program*, UCLA School of Law, Sept. 20, 2004, available at www.sec.gov/news/speech/spcho92004sml.htm. (“We are concerned that, in some instances, lawyers may have conducted investigations in such a manner as to help hide on-gong fraud, or may have taken actions to actively obstruct such investigations.”)

1. An independent committee, consisting of individuals whose conduct is not at issue, should be created.
2. Depending upon the focus of the investigation, the committee consist of:
 - a. The audit committee of the board;

- b. The independent members of that audit committee; or
 - c. The outside (i.e., independent, non-management) members of the board of directors.
3. Where possible, it may be preferable to have the Audit Committee oversee the inquiry since SOX empowers the Committee to conduct such an investigation and requires the company to pay for it. 15 U.S.C. §78j-1(m)(5).
- B. Investigative counsel
1. The decision to select counsel to assist with the investigation should be made by the supervising committee. American College of Trial Lawyers, *Recommended Practices* at 8.
 2. Counsel selected should also be independent for the same reasons that the supervising committee should be independent and impartial. Accordingly, the counsel selected should have few if any prior ties to the company. American College of Trial Lawyers, *Recommended Practices* at 9; Shapiro, *Ethics and Best Practices*; Robert S. Khuzami, Pamela Rogers Chepiga, Pierre Gentin, Lori Marti, Mary Reisert and John Savarse, *Internal Investigations*, 40th Annual Seminar, SIFMA Compliance and Legal Division (Apr. 2, 2008)(“Khuzami, et al., *Internal Investigations*”) at 23-26.
 3. Using regular outside corporate counsel is typically, but not always, disfavored. *See, e.g.*, Speech by SEC Commissioner Campos, "How to be an Effective Board Member," August 15, 2006 at <http://www.sec.gov/news/speech/2006/spch081506.htm> (noting that the committee should have its own independent advisors and investigators).
 - a. Regular outside counsel may be viewed as having an incentive to not criticize those individuals who retained them or with whom they may have had a long-term relationship at the company
 - b. In addition, regular outside counsel may have advised the company on the very transactions at issue in the investigation.
 - c. While regular counsel has the advantage of being familiar with the individuals and the practices of the company, the prevailing view is that an independent and impartial counsel is favored.

4. In some instances, it may be more advantageous for regular outside counsel to conduct the inquiry because of their familiarity with the company, its systems and personnel and the nature of the questions involved. In those instances, the SEC and DOJ may agree that regular counsel should conduct the inquiry.
5. In some instances, in-house counsel may be able to handle some limited investigations, such as violations of employment law, internal personnel policy issues or self dealing.¹⁵
6. The committee should carefully oversee and supervise counsel. While using outside counsel and auditors reflects independence and impartiality, it can also greatly increase cost. A frequent concern is that an investigator may be over-zealous in searching for a wrongdoing in order to justify the expense. The supervising committee must seek a balance between doing a thorough, impartial and independent investigation and harming the reputations of the officers, directors and employees, as well as the company itself. American College of Trial Lawyers, *Recommended Practices* at 10.

C. The Role of the Board of Directors and Management.

1. The focus of the investigation will determine what role (if any) directors and management can play with the supervising committee. In some circumstances, the insider directors and management should not be involved.
 - a. If the corporate entity (as opposed to individuals) is the focal point of a government inquiry, management should not participate in the inquiry.
 - b. If certain directors or members of senior management are alleged to have been involved in the misconduct, they should not be involved in the conduct of the investigation. Their involvement could impact the appearance of impartiality.
2. Involvement of company officials outside of those who are members of the committee supervising the inquiry can result in a waiver of privilege. *See Ryan v. Gifford*, No. 2213-CC (Del. Ch. Nov. 30, 2007).

¹⁵ If in-house counsel is used it may raise questions as to the applicability of privilege since they are frequently involved in business matters, *See, e.g., Navigant Consulting v. Wilkins*, 220 F.R.D. 467 (N.D. Tex. 2004); *TVT Records v. Island Def Jam Music Group*, 214 F.R.D. 143 (S.D.N.Y. 2003).

VI. Initiating and Conducting the Inquiry

- A. Initiating the inquiry: The Board of Directors should pass a resolution directing the committee to conduct a complete and thorough investigation and authorizing it to retain the necessary advisors.
1. Depending upon the scope of the alleged wrongdoing, the committee may also act for the Board, provided that the Board members are not under investigation; or
 2. The committee should be directed to report its finding to the Board.
 3. The Board and the committee should also consider the question of cooperation with the SEC and DOJ, if appropriate. This necessarily involves a resolution of the issues concerning privilege waivers, indemnification, common interest agreements and the related issues as discussed above.
- B. The engagement letter: This letter should define the scope of the inquiry. In some instances, it may identify the allegations or conduct to be investigated. In others, it may simply direct the firm to investigate any and all wrongful conduct. American College of Trial Lawyers, *Recommended Practices* at 11; Shapiro, *Ethics and Best Practices*); Khuzami, et al., *Internal Investigations* at 28. The letter may also:
1. Inform counsel that experts may be retained as necessary with the consent of the committee;
 2. Instruct counsel to advise the committee of its duties, obligations and potential liabilities. Absent a conflict, the general counsel or regular outside counsel will advise the company of its obligations;
 3. Instruct counsel that all documents and data collected, as well as work product, are property of the supervising committee and should be returned to the company at the end of the investigation; and
 4. State that investigative counsel is not authorized to waive either the attorney client or work product privileges without the express authorization of the committee and the Board.
- C. Updates and reports. At the outset, the committee and its counsel should establish procedures for providing reports and documenting the results of the investigation.
1. Many commentators recommend that initial updates of the status of the investigation for be provided orally.

2. Written reports while the investigation is on-going can raise difficulties because they are incomplete and potentially confusing and of limited use. They can also unfairly blemish the reputation of officers, directors or employees involved.
 3. If written reports are prepared, they should be marked with all appropriate privileges and legends (attorney client and/or work product).
- D. Retaining necessary experts. The investigation may require a variety of experts, such as forensic accountants and auditors. Under SOX, the Audit Committee has “the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties.” 15 U.S.C. § 78j-1(m)(5). To maintain the appearance of impartiality and independence, the experts should not be personnel used by the company in its regular course of business. The engagement letter for these experts should specify that they are being engaged by counsel with a view toward rendering legal advice to preserve privilege.
- E. Indemnification. Since any investigation is likely to result in interviews of various employees, the committee should address the issue of indemnification at an early stage (prior to interviewing witnesses). This is typically a question of state law, and may be covered in the by-laws of the company.
1. In considering this issue, if the SEC and DOJ are involved, this discussion should be resolved as part of the issue of cooperating with the government discussed in the previous section.
 2. It is possible to adopt a new policy on indemnification, although the implications of the SEC's actions in *Lucent* (discussed in the prior section) should be considered in that instance.
 3. If indemnification rights are extended, the committee should adopt a policy defining who is covered.
 4. There should be flexibility to expand the scope of indemnity if necessary to cover employees who are not necessary covered by the law, by-laws or policies if necessary.
- F. Initial Dealings with Company Employees
1. Company employees should be advised about the inquiry to secure their cooperation, allay any concerns and forestall baseless rumors. That communication, preferably in the form of a memorandum, should discuss the purpose of the investigation and its anticipated length. The communication should also:

- a. Instruct them to preserve and retain all documents (hard copy and electronic) relating to the investigation (“a litigation hold”).
 - b. Advise them that they will be expected to cooperate with the investigation, including:
 - i. Providing all documents relating to the company when requested (including documents maintained at home or on the employee’s computer) along with a certification of completeness;
 - ii. Submitting to an interview by investigating counsel in which truthful answers must be furnished.
 - c. A related issue which the committee and counsel should consider is the position of the company as to non-cooperating employees. If an employee refuses to cooperate, the company may have the right to terminate the employee depending on state law. Some companies take the position that an employee who declines to be interviewed by investigating counsel fails to cooperate and is subject to termination. Others do not view this as a lack of cooperation. Some companies who have decided to fully cooperate with the SEC or DOJ by waiving privilege have taken the position that employees who invoke constitutional privileges and decline to testify are subject to termination. *But see, U. S. v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006)(finding a violation of the Fifth and Sixth Amendment rights under these circumstances). *See also*, N. Richard Janes, *Taking the Stand. Deputizing Corporate Counsel for the Federal Court*, Washington Law (March 2005) The better practice would be not to penalize employees for invoking their constitutional rights. *See, e.g., Ohio v. Reiner*, 532 U.S. 17, 21 (2001) (per curiam); *Slochower v. Board of Education*, 350 U.S. 551 (1956)(“a witness may have a reasonable fear of prosecution and yet be innocent of any wrongdoing. The privilege serves to protect the innocent who might otherwise be ensnared by ambiguous circumstances. . .”).
2. Employees should be advised of the possibility of indemnification and the fact that the company can recommend counsel. Employees should be informed that investigative counsel is not their attorney.
 - a. Some commentators suggest that the company not advise the employee whether they should obtain their own counsel. Khuzami, et al., *Internal Investigations* at 32.

- b. There may be however, instances where the committee and its counsel may want to deviate from this policy. *Cf. U.S. v. Sawyer*, 878 F. Supp. 295 (D. Mass. 1995)(holding that the company can compel an employee to waive counsel).
- G. The Company's records: A litigation hold. As described above, one of the initial steps taken by the committee is to institute a "litigation hold" as to the companies files. The committee must instruct affected employees to preserve and retain all documents in any form -- hard copy and electronic - - relating to the investigation. The goal of a litigation hold is *preservation*. It does not require the immediate *collection* of the documents – just the preservation. Thomas O. Gorman and Tonya M. Esposito, *Responding to SEC Subpoenas: Cooperation Through Credible Assurances of Complete Production*, 73 Def. Counsel J. 162 (2006) *See generally, Broccoli v. Echo Star*, 229 F.R.D. 506 (D. Md. 2005); *Fergetson Ltd. v. Federal Exp. Corp.*, 247 F.3d 423 (2d Cir. 2001) (duty to preserve documents arises when the party has notice of possible claim.
1. Subjects and employees involved: In order to institute a litigation hold, the company needs to identify the subject matters and employees who may have materials. This may require an initial review of the issues and some interviews.
 - a. Some commentators recommend that this review be done by the general counsel's offices and regular outside counsel who have the best knowledge of these matters. This process also ensures that the identification is done quickly. American College of Trial Lawyers, *Recommended Practices* at 16.
 - b. Others suggest that it should be done by counsel to the committee. Shapiro, *Ethics and Best Practices*.
 2. Instruction to employees: Once the topics and employees are identified, a litigation hold e-mail or memorandum, directing those employees to preserve the documents and cautioning them that no document should be destroyed without counsel's permission.
 - a. The hold should include all "hard" or "paper" documents, including the actual files and correspondence relating to the transaction or event. It may also include calendars, daily diaries, telephone message logs.
 - b. The hold also must include electronically stored information. A check list would include e-mail, calendars, information stored on personal digital assistants, documents maintained on word-processing systems (including

metadata) and hard drives of computers of departed personnel.

- i. If the company has an automatic deletion process for its e-mails, steps should be taken to preserve the e-mails as of the date of the litigation hold before any documents are deleted; and
- ii. If the company recycles “backup tapes” of its network, the company may need to take to preserve the most recent set of tapes.

H. Monitoring compliance: Counsel to the committee should monitor the company’s retention to ensure compliance with the litigation hold. *See e.g., Qualcomm v. Broadcom* 05-CV-1958-B (BLM) *slip op.* (S.D. Cal. Aug. 6, 2007) (holding that counsel has an affirmative obligation to ensure proper document production); *Zubaulake v. UBS Warbug*, 2004 WL 1620866 (S.D.N.Y. July 20, 2004)(not sufficient to simply tell employees, counsel must take affective steps to monitor).

I. Collecting the documents: Once the documents are preserved through a litigation hold, they should be collected as early as possible to assist in establishing the factual background and creating a foundation for witness interviews.

1. If counsel for the committee has not been appointed yet, general counsel or regular counsel should collect the documents. The documents should be treated as if the matter is in litigation. Shapiro, *Ethics and Best Practices*; Khuzami, et al., *Internal Investigations* at 42.
2. The review and analysis of the documents should be undertaken by counsel to the committee with, if necessary, specially retained technology or other experts. The documents can be used to build a fact chronology. Appropriate steps should be taken to ensure that it is protected by the work product privilege. Accordingly, it should not be shared with the witnesses.

J. Witness Interviews

1. Preliminary issues: Key issues which should be resolved by the committee and its counsel prior to beginning the interviews include:
 - a. Indemnification: Which witnesses will be provided with counsel paid for by the company;

- b. Documents: Whether the company will make available documents and relevant materials for review by the witness and his or her counsel prior to the interview. This question overlaps with the issue of joint defense agreements with witnesses and should be considered in conjunction with the assessment of cooperation with the SEC and DOJ. Some investigators do not grant the witness access to documents. The better practice however, seems to be to permit the witness to review the pertinent materials. This ensures that the witness has the opportunity to properly review and refresh his or her recollection. It should also enhance the fact finding process.
2. Participants in the interviews: Counsel to the committee should identify potential witnesses and conduct the interviews. Some commentators suggest that a minimum of two lawyers be present for the interview.
 - a. Since it is possible that the persons conducting the interviews may be called to testify as to what transpired during the interviews, careful consideration should be given to who participates.
 - b. The committee should determine whether some one from the general counsel's office should present. This can have a chilling effect on the interview, which is a significant reason not to include such a representative. There may however, be other reasons which suggest that the representative should be present. Cf. George Ellard, *Making the Silent Speak and the Informed Wary*, 42 Am. Criml. Rev. 985 (2005) (counsel is in effect a government representative following *Kumar*).
3. Refusals to cooperate: The committee and its counsel should consider how to handle witnesses who refuse to cooperate with the internal investigation. A related issue concerns how to deal with an employee who cooperates with the company's inquiry, but declines to cooperate with the SEC or DOJ.
 - a. Usually the employee can be terminated, although the company should review applicable state employment law on this issue. Indeed, the SEC has criticized companies who do not take action against employees who refuse to cooperate. See, e.g., *In the matter of Cooper Companies, Inc.*, Exchange Act Release 35082 (Dec. 12, 1994) (The misleading nature of the press statement was compounded by the non-disclosed facts that two employees asserted their Fifth Amendment privilege in refusing to testify in the

Commission's investigation and had similarly refused to be interviewed in the company's own internal investigation).

- b. A secondary problem is how to handle an employee who cooperates with the internal investigation, but does not cooperate with a government investigation (*i.e.*, invokes his or her Fifth Amendment Rights). The company may be able to terminate the employee or not advance legal fees. However, the better practice would be to not punish an employee for exercising his or her constitutional rights as discussed earlier. *Cf.* George Ellard, *Making the Silent Speak and the Informed Wary*, 42 *Am. Criml. Rev.* 985 (2005) (counsel is in effect a government representative following *Kumar*).

K. Conducting the interview:

1. Preliminary warnings or the "Upjohn warnings."¹⁶ Prior to conducting an interview, counsel should inform the witness that he or she represents the committee only. The witness should be clearly informed that investigating counsel does not represent the witness. These warnings are sometimes called the Upjohn warnings. *See, e.g.* Webb, et al. *Corporation Internal Investigations*, Section 9.06[1] *In re: Grand Jury Subpoena Under Seal*, 415 F.3d 333 (4th Cir. 2005) *cert. denied*, 200 U.S. LEXIS 229 (Jan. 9, 2006) (discussing Upjohn warnings in context of a claim by a witness alleging a jointly held privilege with the company where incomplete warnings given; court rejected claim). Failure to give the appropriate warnings can result in the disqualification of counsel and create other difficulties. *See, e.g.*, *In re Grand Jury Subpoena*, 144 F.3d 652 (10th Cir. 1998); *Advanced Mfg. Tech. Inc. v. Motorola Inc.*, 2002 WL1446953 (D. Ariz. 2002); *U.S. v. Int'l. B'Hood of Teamsters*, 119 F.3d 210 (2nd Cir. 1997)
2. Requests for counsel. If an employee asks whether he or she needs counsel, investigating counsel should state only that he or she is not the employee's lawyer, but will adjourn the interview for a reasonable period to allow the employee to consult an attorney. Some commentators recommend employees with potential criminal exposure be advised that it may be in their best interests to retain counsel. Shapiro, *Ethics and Best Practices*; Khuzami, et al., *Internal Investigations* at 32.

¹⁶ *See, Upjohn Co. v. U.S.*, 449 U.S. 383, 386-396 (1981).

3. Privilege: The witness should be informed that, although the attorney-client privilege applies to the investigation, the company can elect to waive the privilege and reveal what was said during the interview to others, including the SEC, DOJ or other agencies and regulators. If the company has already decided to waive privilege and cooperate with the SEC or DOJ, the witness should be advised of this fact, particularly in view of the trend toward deputization discussed above.
4. Non-cooperation: If the committee has made a decision on how to handle employees who refuse to cooperate, that decision should be communicated to any employee who in fact does refuse to cooperate.

L. Post Interview

1. Counsel should prepare a work product memorandum of the substance of the interview afterwards.
 - a. Some commentators recommend that counsel note in the memorandum that it does not purport to be verbatim transcripts and contains observations and opinion of counsel to increase the likelihood that the document will be viewed as attorney work product. Shapiro, *Ethics and Best Practices*.
 - b. Others recommend that the Memorandum identify and describe the warnings given to each witness. Khuzami, et al., *Internal Investigations* at 41.
2. If the witness was represented by counsel, investigating counsel should consider giving the witness and his or her counsel an opportunity to review the memorandum and make recommendations regarding possible modifications. This is particularly true if the memorandum is going to be turned over to the government. American College of Trial Lawyers, *Recommended Practices* at 19-20.
 - a. To preserve privilege investigating counsel should consider creating a common interest arrangement. While there is little authority on this point it in the view of the American College of Trial Lawyers, the common interest privilege should preserve the work product protection for the document. American College of Trial Lawyers, *Recommended Practices* at 19-20.
 - b. On common interest agreements, *see generally*, *Ryan v. Gifford*, 2007 WL 4259557 (Del. Ch. Nov. 30, 2007); *Saito*

v. McKesson HBOC, Inc., No. 18553, 2002 WL 31657622 at *4 (Del. C. Nov. 13, 2002); *Jedwab v. MGM Grand Hotels, Inc.*, No. 8077, 1986 WL 3426, at *2, (Del. Ch. Mar. 20, 1986).

M. Reporting the Findings

1. Interim reports:

- a. Counsel's record. During the inquiry, counsel should keep and continuously updated a record of the witnesses and documents examined. As discussed above, a memorandum should be prepared of each interview. All of these materials should be prepared as work product of counsel.
- b. Oral reports to the committee. During the investigation, periodic oral reports should be given to the committee. Written interim reports should be avoided since not only are they incomplete, but their later production could cause significant difficulties, harm and prejudice to some individuals. A written report at an interim stage creates certain risks.

2. The Final Report. The form of the final report, whether it is written or oral, and to whom it is delivered are significant issues which must be resolved by the committee and its counsel.

a. Pros and Cons: a written report.

- i. PRO: A written report focuses the findings and conclusions.
- ii. PRO: It is useful for reviewing with senior management.
- iii. CON: It should be written as if it will end up in the hands of prosecutors and third-parties, and may be damaging to the company and officers, directors and employees discussed in it.

3. The committee has a fiduciary duty to review the findings and/or recommendations of counsel and draw its own conclusions, not simply accept the findings of counsel. The committee should report its conclusions in accord with resolution under which it was created.

VII. Conclusions

- A. In the post-SOX era, internal investigations have become almost common place. Before an investigation is undertaken, the company should carefully consider the need for the inquiry.
- B. If there is a decision to undertake the inquiry, its scope and links should be defined in view of its purpose.
- C. If the inquiry is being conducted to self-report or otherwise cooperate with the SEC, DOJ or another agency, careful consideration should be given to questions concerning cooperation, privilege waivers, indemnification and common interest agreements in view of the impact of these issues on any potential cooperation credit.
- D. The inquiry should be conducted by an independent committee. That committee should retain independent counsel. The appearance and fact of independence is typically critical to the credibility of the inquiry.
- E. Prior to the beginning of the inquiry the committee should:
 - 1. Prepare an engagement letter defining counsel's obligations;
 - 2. Assess the question of cooperation;
 - 3. Determine the manner in which counsel should report during the inquiry and at its conclusion;
 - 4. Prepare a memorandum to employees regarding the inquiry;
 - 5. Consider potential employee issues; and
 - 6. Establish a litigation hold over the pertinent documents.
- F. During the inquiry counsel should:
 - 1. Give periodic oral reports;
 - 2. Create a written record of the inquiry that is privileged; and
 - 3. Create privilege memorandum of witness interviews.
- G. At the conclusion of the inquiry:
 - 1. Counsel should report to the committee as directed; and
 - 2. The committee should report as directed.