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Internal Investigations

Internal investigations are not a new feature of the corporate landscape. The appointment of special counsel to investigate and report on the Securities and Exchange Commission's allegations of wrongdoing was a common feature of S.E.C. consent decrees in the early 1970's. Voluntary disclosure policies, including those adopted by the S.E.C. in the mid-1970's and by the Department of Defense in 1986, reaffirmed the value of internal investigations under certain circumstances. Recent large scale settlements and corporate upheaval in the wake of alleged wrongdoing have underscored that internal investigations can, if handled correctly, play a vital role in corporate management.

The central purposes of an internal investigation are to explore potential misconduct and to lay the foundation for devising and implementing appropriate remedial measures. An internal investigation may be initiated by management or prompted by an external event such as the receipt of a grand jury subpoena or the initiation of a civil lawsuit or agency inquiry. The context in which an internal investigation arises significantly shapes its timing, form, substance, and documentation.

I. When to Consider an Internal Investigation

Management should consider the advisability of an internal investigation whenever it becomes aware of potential employee misconduct. In so doing, management must bear in mind its duty to act in the company's best interest, as well as the company's potential criminal liability for an employee's misconduct if the employee acted within the scope of his employment and intended, at least in part, to benefit the organization.

The factors militating in favor of an internal investigation are especially compelling -- if not overwhelming -- in the context of a private suit or government inquiry. It is axiomatic that management must do all it can to prepare an informed defense to existing or anticipated allegations of wrongdoing. Moreover, facts uncovered during an internal investigation may argue persuasively against prosecution. The facts may convince the government that as a matter of law, an enforcement action cannot be sustained against the company or, as a matter of policy, that investigative, enforcement and prosecutorial resources would be more effectively utilized if directed elsewhere. An exhaustive review of the facts may, at the very least, offer support for a lighter penalty. An internal investigation that yields corrective action may also reaffirm a company's integrity in the eyes of the government and general public.

Even outside the context of a private lawsuit or government investigation, a company's potential exposure may militate in favor of an internal investigation. The investigation may be required for the company intelligently to fashion prophylactic or remedial policies and procedures. Against these considerations the company must weigh the investigation's cost and other potential drawbacks, including the potential repercussions if confidentiality is not maintained.

II. Who Should Conduct the Internal Investigation

If management decides that it is advisable to initiate an internal investigation, management must next determine who will conduct it. This analysis invariably requires selection of experienced counsel.

It is of obvious benefit to the company if its factfinder is sensitive to the full panoply of legal issues raised by internal investigations. Counsel can structure the investigation in a manner that will enhance the application and preservation of the attorney-client privilege and work product doctrine. Counsel can weigh the benefits of and draft joint defense and confidentiality agreements if necessary. Counsel will be well-versed in the criminal statutes that potentially apply to the process, including those governing perjury, witness tampering and obstruction of justice. At each and every stage of the investigation, counsel can offer substantive guidance about the rights, obligations and liabilities of the company and its employees.

Management should consider whether these functions are best performed by outside or in-

house counsel or some combination of both. At a minimum, management should analyze whether outside counsel is apt to be perceived as more independent, whether in-house counsel is a witness to the events at issue, and whether outside counsel has superior substantive expertise or trial experience to offer. Ideally, counsel should also have a proven track record of dealing effectively with prosecutors and regulators. Cost is another obvious factor to consider.

If in-house counsel is selected to conduct the investigation, he should distinguish clearly between his legal advisory role and his business advisory role. If outside counsel is engaged, counsel's retention should be memorialized in a document clearly setting forth that counsel is being directed to conduct an investigation and render legal advice in anticipation of litigation.

III. Structuring The Investigation

The scope of the investigation and reporting lines should be delineated early on.

It is crucial that at the outset, management and counsel clearly define the scope of the investigation and establish reporting lines. They should consider, among other things, the extent to which the company's outside directors should be involved.

The groundwork should also be laid for preserving the attorney-client privilege and work product doctrine which together are the principal vehicles for preserving the confidentiality of the ensuing inquiry. These protections attach under strictly defined circumstances, and a limited waiver of the privilege (even inadvertent) may open the door to a broad inquiry by the government or civil litigants.

IV. Conducting the Investigation

Document analysis and witness interviews are the linchpins of the investigation.

The cornerstones of the internal investigation are: (1) collecting, organizing and analyzing documents; and (2) witness interviews.

The document process commences with the systematic and exhaustive collection of all relevant materials. In the first instance, counsel must familiarize himself with the company's organization, filing system and document retention policy. Once the pertinent universe of

documents has been isolated, it must be preserved by photocopying, imaging or otherwise. The documents are then marked for identification and privilege, and then organized in a manner that permits them to be processed intelligently. Counsel should consider whether documents should be encoded and summarized on a database to facilitate their efficient retrieval and use.

The isolation of key documents and development of a chronology are central goals of this process. Documents also must be handled in a manner that preserves all applicable privileges.

Witness interviews should be conducted with equal care. Counsel should prepare for interviews by familiarizing himself with pertinent documents. In addition, at the outset of the interview, counsel should make it clear that he represents the company, not the employee, and that the interests of the company and employee may be adverse. Counsel should also explain that the interview is being conducted pursuant to the company's attorney-client privilege, that facts are being gathered so that counsel can advise the company in anticipation of litigation, and that the company has sole discretion to waive its privilege at any time. The interview should be documented in a fashion designed to protect its contents.

An employee with interests potentially adverse to the company's may elect to retain his own counsel. The employee may be entitled under his employment contract, company by-laws, or otherwise to indemnification for his legal expenses under certain circumstances.

Assuming that any applicable joint defense agreement does not compromise the interests of the company, counsel for the company should make every effort to ensure that his communications with the employee or his counsel are protected by the "joint defense" or "common interest" privilege in jurisdictions where it is recognized.

V. Documentation and Disclosure of Findings

Management must confront the delicate issues of documentation and disclosure.

One of the difficult decisions confronting counsel and management is whether to reduce to writing the findings and conclusions of an internal investigation.

The benefits of a detailed report may include its promotion of the development of policies and

procedures tailored to avoid any future misconduct. Other potential benefits flow from disclosing a written report that offers detailed, tangible evidence of a thorough investigation: the report may be used to convince an agency that exculpatory evidence exists, that no misconduct occurred, that any misconduct took place under mitigating circumstances, or that the company has undertaken an in-depth investigation and is well on its way to putting its house in order without government interference; the report may meet disclosure obligations imposed by a government agency; and the report, if compiled in the wake of a shareholder derivative action, may offer compelling documentation of the reasons why the suit should be terminated.

The risks of a written report often outweigh the benefits, however. Applicable rules of evidence may permit any "admissions" to be used against the company in a private or government proceeding. Production of the report may waive privileges otherwise protecting the underlying information, thereby exposing the company to civil or criminal liability. The report may contain assertions that expose both its authors and the company to libel suits.

Any report prepared should be distributed only on a "need to know" basis, with as few copies generated as possible. The report should make clear that it was prepared in response to a request by the company for legal advice. Recipients should be admonished to keep the report and its contents confidential.

Even in the absence of a written report, the company must consider the extent to which the results of its internal investigation should be disclosed. The general rule is that a company has no duty voluntarily to disclose information suggesting criminal conduct. Active concealment, affirmative misrepresentation or partial disclosure will put the company at risk, however. Moreover, certain industries are subject to independent statutory disclosure requirements. The requisite analysis is delicate and case specific; management should consult closely with counsel to ensure that it is fully cognizant of all disclosure obligations that apply.

Even absent a duty to disclose, management may nevertheless conclude that disclosure is in the company's best interest. In addition to the foregoing considerations, management should assess whether it can shield itself from criminal prosecution by taking advantage of a formal disclosure program adopted pursuant to agency guidelines.

VI. Impact of Federal Sentencing Guidelines

The federal sentencing guidelines for organizational defendants are intended in part to reflect the principle that the range of fines for organizations should be based on the seriousness of the offense and the culpability of the organization. Culpability generally is determined by the steps that the organization takes prior to the offense to prevent and detect criminal conduct, the level and extent of involvement in or tolerance of the offense by certain personnel, and the organization's actions after an offense has been committed. The guidelines specifically provide that an organization's criminal penalty may be reduced if it: (1) voluntarily discloses the offense to appropriate governmental authorities within a reasonably prompt time after becoming aware of the offense and before an imminent threat of disclosure or government investigation; (2) cooperates fully in the subsequent government investigation; and (3) clearly recognizes and accepts responsibility for its criminal conduct.

Should management determine that it is in the company's best interest to disclose the results of its internal investigation, then management should carefully evaluate by who, when, and to whom that disclosure should be made. Like the many other facets of internal investigations, this requires an informed analysis of complex factual, tactical, and legal issues.

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