

# The Practice and Pitfalls of Internal Investigations: How to Keep Both Your License and Your Sanity

Mark Bartlett  
Davis Wright Tremain LLP



# When Do You Need to Investigate?

- Red Flags
  - Questionable accounting (restatement)
  - Suspicious stock sales
  - Doubts about management's integrity
  
- How Red Flags can be raised
  - Government inquiry or subpoena
  - Self-Regulatory Organization
  - Private plaintiffs (securities and derivative)
  - Auditors
  - Whistleblowers
  - Media – including Internet Blogs



## Benefits of Internal Investigations

- Reduces exposure to government action
- Provides information that enables management and directors to fulfill their responsibilities
- Presents opportunity to correct problems before they lead to litigation or worse
- Permits Board to retain control



## Risks of Internal Investigations

- Costly and time-consuming
- Can create evidence that private plaintiffs or regulators will use against you
- No guarantee SEC or DOJ will find investigation sufficient
- Government may press for privilege waiver
- If leaked, mere fact of investigation may invite interest from private plaintiffs or regulators



## In-house Investigators or Outside Counsel?

- Use in-house investigators when:
  - Allegations are relatively routine
  - Allegations involve relatively minor technical or reporting errors
- Use outside counsel when:
  - Company suspects misconduct by officers or high level employees
  - Misconduct has been systematic or is ongoing
  - Potential financial exposure is significant
  - Subject matter is likely to result in law enforcement activity or media coverage



## Five Step Investigative Plan

1. Secure and assemble relevant documents
2. Identify relevant witnesses
3. Prioritize witness interviews
4. Identify key legal issues and defenses
5. Identify and retain any necessary experts



## Document Retention/Deconstruction

Regardless of whether there is an ongoing government investigation, normal operation of document retention/destruction policies should be immediately suspended during the internal investigation.



## Sarbanes-Oxley

- New federal crime for knowingly destroying or concealing any document with the intent to obstruct or influence the investigation or proper administration of any matter within a federal agency's jurisdiction, or in relation to or contemplation of any such matter
- Government can reasonably argue that internal investigation is in contemplation of an agency investigation





## Provide Proper Upjohn Warnings

- Nature and purpose of the investigation
- Interviewer is counsel for the corporation or board committee – **not** the employee
- Privilege belongs to the corporation or committee and may be waived
- Substance of the interview may be disclosed to management, the board, regulators, or prosecutors
- Expectation of cooperation
- Right to separate counsel



## Expectation of Cooperation

- Employee has right to refuse to be interviewed, **but** may face adverse consequences
- Interviewee may face criminal liability for lying or misleading lawyers during internal investigation
  - Obstruction charges against witnesses who lied to counsel conducting internal investigation
    - *United States v. Kumar* (Computer Associates)
    - *United States v. Singleton* (El Paso Corporation)



## Potential Consequences of Prosecution

- Large criminal fines (up to twice the gain or loss)
- Potential collateral estoppel in civil shareholder litigation
- Regulatory sanctions/debarment for government contractors
  - Foreign Corrupt Practices Act
- Debt covenants may be triggered by criminal charges
- Professional services firms may not survive reputational damage
  - Arthur Andersen Accounting (Enron)



## DOJ Corporate Charging Guidelines

- Nature/Seriousness of offense
- Pervasiveness of wrongdoing/complicity of management
- Corporation's history of wrongdoing
- Timely/Voluntary disclosure and cooperation
- Effective pre-existing compliance program
- Response/Remedial action
- Collateral consequences of prosecution
- Adequacy of individual prosecutions
- Adequacy of civil/regulatory actions

Source: USAM 9.28-300



## Avoiding Prosecution

Prosecutors less likely to charge the corporation if:

- Corporation timely and voluntarily discloses wrong doing
- Corporation cooperates by disclosing relevant facts
  - August 2008 change in USAM that eliminated privilege waiver requirement
- Corporation takes corrective action – disciplines wrongdoers
- Corporation has effective compliance program



### *Waiving privilege in government investigation may waive in civil litigation also*

- In the context of securities fraud investigations, company may be vulnerable to civil suits involving significant potential monetary damages
- *FDIC vs. Baker Botts and Ernst & Young*



## Independence of Investigators

- Independent attorneys and forensic accountants
- Not a “whitewash”
  - Accusation against Vinson & Elkins in Enron
- If it is later deemed not to be independent, you may have to redo the investigation
- Independence less important if top management appears not to be involved



## SEC's Seaboard Report

- Did the company commit to learn the truth fully and expeditiously?
- Did the company thoroughly review the nature, extent, origins and consequences of the conduct and related behavior?
- Did the company promptly make available to SEC staff the results of its review?





## Minimizing Impact, Maximizing Outcome

- Anticipate impact actions will have on private litigation
- Consider using proffers, but ensure full knowledge of relevant facts
- Clearly explain that cooperation is an all or nothing proposition
- Establish an early and honest dialogue with government