Watching Your Step: Avoiding The Pitfalls And Perils Of Corporate Internal Investigations – Part II

Paul B. Murphy and Lucian E. Dervan
KING & SPALDING LLP

To conduct a credible and accurate investigation, counsel should interview everyone with relevant information. When conducting interviews, however, the attorney must be mindful that an employee interview is a fact-finding exercise, not an opportunity to “woodshed” the witness into adopting a version of events most favorable to the corporation. In that regard, counsel must ensure that the manner in which the interview takes place cannot be interpreted later as witness tampering. 18 U.S.C. §1512(b)(1), in part, makes it illegal to “engage in misleading conduct towards another person with intent to… influence… the testimony of any person in an official proceeding.” This statute is extremely expansive to capture overly aggressive, improperly manipulative interview methods. Similarly, the statute’s intent-to-influence standard has a far reach. As one commentator observed, the acts of “[r]efreshing a witness’ recollection, pointing out inconsistencies in his testimony, suggesting how he might handle expected questions on cross-examination, even simply using leading questions in an interview – all are proper and even necessary methods of preparing a witness, and all have the objective as well as the effect of ‘influencing’ testimony.” Finally, for purposes of section 1512, “an official proceeding need not be pending or about to be instituted at the time of the offense …,” meaning that the statute can apply to conduct at the most preliminary stages of an attorney’s internal investigation.

Another important aspect of a credible investigation is ensuring that the documents necessary to make accurate findings are present and available for review. Without the relevant materials, it may be difficult or even impossible to make well-supported conclusions about the conduct under investigation. The first step in this process is to make certain that the proper document retention procedures are implemented immediately, which includes suspending any procedures for document destruction. Electronic documents, including emails, also should be secured for future review. The prompt distribution of a document preservation memorandum by the company will help prevent the inadvertent destruction of relevant documents and serves as an important prophylactic measure in light of the Corporate Fraud Task Force’s aggressive position on document destruction and the new broader prohibitions on document destruction implemented by the Sarbanes-Oxley Act. Section 1102 of Sarbanes-Oxley amended 18 U.S.C. §1512 to reach individuals who actually destroy or shred documents, not just those in a supervisory position who order their destruction, while Section 802 of Sarbanes-Oxley created an entirely new criminal statute, 18 U.S.C. §1519, which has been termed the “New General Anti-Shredding Provision.” This latter statute, carrying a twenty year maximum punishment, covers the alteration or destruction of documents in relation to or contemplation of any government investigation. This means that the statute reaches the destruction of documents that relate to an investigation, even though the documents may be useless and there is only some possibility of a future investigation by the government. Along with preserving documents at the outset of an investigation, therefore, both companies and attorneys must consider retaining materials that relate to the internal investigation itself, including attorney work papers and interview notes.

Finally, while corporations need to take appropriate disciplinary action against culpable employees, attorneys and their clients should first study Section 302 of the Sarbanes-Oxley Act, codified at 18 U.S.C. §1514A. This statute prohibits public companies from retaliating against an employee for providing to certain parties – including a “person working for the employer who has the authority to investigate” – information that the employee reasonably believed constituted a violation of federal fraud statutes or securities laws. The statute gives the aggrieved employee a right of action to seek reinstatement, back pay, and damages. With its implicit reference to counsel conducting an internal investigation for the company,
the statute has the potential to snare unsuspecting attorneys who do not think to advise their clients about the importance of treading carefully when it comes to dealing with employees who may qualify as whistleblowers.

Preparing For The Disclosure Issue

Although counsel conducting an internal investigation should take steps to safeguard the company’s attorney-client privilege, she should always keep in mind that, at some point, it may be necessary or even advantageous for the company to disclose the results of the investigation and, perhaps, even materials generated during the inquiry. Today, numerous parties have an interest in securing materials collected or created during an internal investigation, including any written report issued at the conclusion of the investigation. The question of disclosure, including the scope of any disclosure, is a fact-specific decision that turns on the circumstances of each case, with no “one-size-fits-all” solution to this often complicated issue. Nevertheless, in advising the corporation on the disclosure question, investigation counsel should take into account certain common considerations and advise the corporation to weigh carefully the advantages and disadvantages of disclosing the results of the investigation to third parties.

When dealing with the government, the corporation’s timely and voluntary disclosure of wrongdoing will often work to its advantage. In determining whether to charge a corporation, the Department of Justice advises prosecutors to weigh the “timely and voluntary disclosure of wrongdoing and its willingness to cooperate with the government’s investigation.” On the issue of disclosure, the Thompson memorandum also informs prosecutors to examine “the completeness of [the corporation’s] 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 officers, directors and employees and counsel.” While the Thompson memorandum makes it clear that such waivers are not an “absolute requirement,” requests for waivers are becoming increasingly frequent – and not just by the Justice Department. Other agencies, such as the SEC, are also requesting waivers. If confronted with such a request, counsel must consider the collateral consequences of a waiver and, if necessary, should explore with prosecutors whether a waiver is absolutely essential to advance the government’s interests. In some cases, counsel may be able to reach a middle ground with prosecutors that satisfies their concerns while maximizing the corporation’s ability to preserve the attorney-client privilege.

Even if disclosure to the government does not forestall criminal charges, it can significantly reduce the corporation’s exposure to criminal penalties. The Federal Sentencing Guidelines also contain language equating cooperation with a disclosure of “pertinent information,” including, if necessary, privileged material. When calculating the applicable fine for a corporation under the Guidelines, the culpability score is impacted by the corporation’s cooperation. In discussing this requirement, comment 12 of section 8C2.5 of the Guidelines states that “[w]aiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score… unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.” In such situations, counsel and the corporation will have to consider the likelihood of prosecution and the need for a disclosure of privileged material, and decide between receiving the reduced culpability score and the collateral consequences that may flow from a waiver.

In addition to law enforcement and regulators, external auditors for public companies have become increasingly aggressive since the passage of Sarbanes-Oxley in requesting the disclosure of information developed or created during an internal investigation, such as interview memoranda or document collections, as well as any final report issued to the company. While auditors may not couch a request for information as requiring a waiver of the corporation’s attorney-client privilege, complying with such requests for information in most instances will present waiver issues that require careful analysis and consideration by counsel and the company. In addition to seeking information relating to the investigation, auditors also are frequently asking investigating counsel whether the company or any of its employees committed “illegal acts,” as defined by 15 U.S.C. §78j-1(f). These requests exceed the scope of information required under the ABA-AICPA “Treaty” and, in addition to presenting significant waiver issues, raise the possibility that the identification of such acts could later be used against the company. Accordingly, counsel and the corporation should give significant thought to the nature and scope of any disclosures made to external auditors, while keeping in mind the possibility that refusing the requested material may lead to a qualified audit opinion or the refusal to issue any opinion.

The most significant danger associated with a disclosure to third parties, whether the government or external auditors, is that it may result in a waiver of the attorney-client privilege that extends far beyond those to whom the disclosure is made. In some cases, waiver may present little concern. In other cases, however, waiver may result in collateral consequences because of other ongoing or anticipated proceedings, including class action or shareholder lawsuits. Selective waivers, in which the privilege is waived as to one or more third parties while asserted against all others, have met with mixed results, even where a confidentiality agreement exists. Although a few courts have permitted selective waivers to the government, the overwhelming majority have rejected such efforts. Similarly, some courts have permitted selective waivers to external auditors, though most have found that such disclosures constitute a waiver as to all parties. Counsel should assume that a waiver with regard to either the government or an auditor will make the material accessible to third parties in the other contexts, including plaintiffs’ attorneys and stockholders. If a disclosure is deemed to have been a waiver as to third parties, consideration must be given to the breadth of the waiver. As a general matter, such a waiver will be considered a waiver as to all materials relating to the same subject matter, though the definition of “subject matter” varies from case to case. In the end, therefore, what may have appeared to be a narrow waiver to the Department of Justice, the SEC, or an audit firm could become a much broader waiver that places the entire investigation, or at least the particular material for which privilege was waived, into the hands of groups adverse to the client.

Conclusion

The issues that make internal investigations unique are overlapping and complex. Often times, a single misstep by counsel can have a cascading effect and impact the entire course of the investigation and even the company’s ability to deal successfully with prosecutors or regulators. In preparation for the challenges that can surface in this practice area, attorneys always should consider the various issues that they will likely confront and anticipate what can go wrong as they work through each decision. Only through such diligence can attorneys successfully navigate the course that allows them to achieve the best results for their corporate clients.

---
