Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

An Internal Investigation Playbook For Energy Cos.: Part 2

By **Dixie Johnson, Brandt Leibe and Grant Nichols** (October 29, 2019, 4:22 PM EDT)

Dixie Johnson

Brandt Leibe

Grant Nichols

Energy companies regularly face challenges that may require an internal investigation to determine the root cause of an issue, in order to evaluate how best to remediate and guard against future harm. From corruption to data breaches, environmental catastrophes to human resource issues, there are more than enough landmines in today's legal environment to keep any energy company's general counsel up at night.

This three-part article is designed to help navigate through the myriad decisions, twists and turns of an internal investigation. The first installment discussed reviewing company policies, determining the scope and structure of an investigation, and the importance of data preservation. This installment covers conducting witness interviews, compiling an investigation report, and the special obligations of independent auditors.

Witness Interviews

When?

Different investigations require different strategies. In some investigations, it is important to talk with witnesses quickly, even before any documents have been reviewed, and then perhaps interview them again with a document set once those conducting the investigation know more. In other situations, reviewing the documents before interviewing witnesses is essential to an orderly and efficient process.

Where?

Usually the interviews occur in a conference room at the company's offices, preferably in an area that allows the process to remain as confidential as possible. Often, the lawyers conducting the investigation travel to the office location for each witness. Some interviews may be conducted by video conference or telephone, although neither of those situations is ideal.

Who Participates?

Those conducting the investigation typically would lead the interviews.

When board members are overseeing or leading the investigation, various board members might want to attend the witness interviews, and perhaps even ask questions of the witnesses. This certainly is not required — as board members are entitled to rely on the experts they hire to conduct the investigation — and could present complications.

In-house counsel sometimes attend witness interviews that are being conducted by outside counsel. Depending on the circumstances, the presence of in-house counsel could make witnesses more or less comfortable. It is important to ensure that witnesses feel free to provide accurate information and frank views.

Supporting consultants may also attend and participate in interviews, depending on the circumstances.

Counsel for the Witnesses?

Companies typically are not required to provide counsel to employees during internal investigations, and witnesses often are not represented during internal investigations. This is particularly true when the investigation is being conducted by company employees (from the internal audit, compliance or legal department). It also is often the case when outside counsel is asking the questions.

Counsel representing the company or a board committee in the investigation typically cannot advise witnesses as to whether they need their own lawyers, even if the witnesses request that advice.

When companies decide to make counsel available to employees, companies sometimes engage “pool counsel” who would be available to represent multiple employees during the internal investigation. Pool counsel would be responsible to ensure that they could ethically conduct a joint representation without encountering insurmountable conflicts of interest or revealing confidential information. Pool counsel arrangements usually are set up so that the company pays the bills, but the attorney-client privilege would not include the company.

Senior officers may want counsel of their own, and companies often honor this request, even if a short delay occurs while the officer selects an attorney. Legal departments and outside counsel may have recommendations tailored to the specific subject matter, potential government interest or other factors.

Officers and employees may want the company to pay the bills for their individual counsel. Whether the company is obligated to do so often turns on provisions in employment agreements and corporate governance documents such as by-laws.

Companies often indemnify officers, which usually entails reimbursing fees at the end of a process once it is determined that the officer is entitled to indemnification (e.g., acted in good faith), and also advance indemnification payments along the way so the officer does not bear legal fees out of pocket. Companies typically require officers to sign an undertaking to repay any advanced amounts, if it is determined that the officer is not entitled to indemnification.

The cost of legal fees and expenses may be covered by director and officer insurance, although if no litigation has been filed, coverage is less likely. Coverage will be governed by the policy and negotiations with the carriers.

Sometimes, witnesses want to bring their own individual counsel to the internal investigation interview. Companies typically evaluate whether to proceed with interviews with counsel based on the relevant circumstances at the time.

Upjohn Warnings

At the outset of interviews of company employees conducted by counsel for the company, it is important that the witness understand as much about the context as the investigators can share. It also is essential that the witness understands that the investigators do not have an attorney-client relationship with the witness.

The concept of Upjohn warnings comes from Upjohn Company v. United States,[1] in which the U.S. Supreme Court held that a company's attorney-client privilege is preserved when the company's attorney communicates with the company's employees.

The warning typically clarifies that:

- The lawyers represent the company (or the board committee) and not the employee;
- Communication occurring during the interview is protected by the company's attorney-client privilege; and
- Only the company will control whether to provide information learned through the interview to anyone outside of the company, including a government agency.

Documentation of the Witness Interviews

Attorneys often take notes during the interviews, and practices differ as to whether the notes are in the form of a transcript or include the attorney's inferences, shorthand and mental impressions. The latter are more easily protected from discovery.

Interview memoranda are more formal records of the communication during the interview. These often are created by one of the lawyers who attended the interview, and then may be edited by other lawyers on the team.

Interview memoranda typically would be protected from third party access by the company's attorney-client privilege and, depending on the circumstances, by the attorney work product doctrine. Creation and completion of interview memoranda is time-consuming and expensive, and it is important to determine whether that expense is necessary under the specific circumstances of the investigation.

Investigation Report

Investigation findings may include conclusions regarding:

- Whether the company and/or individuals violated the law, rules or regulations;
- Whether the company and/or individuals violated company policy;

- Whether, given their conduct as determined by the investigation, company officers and employees can be relied upon by the company's independent auditors:

    - Were senior management's representations to auditors accurate?
    - Were their certifications of financial statements accurate?
    - Were their representations to lenders, analysts and shareholders accurate?
    - Was the tone they set at the company supportive of ethical conduct by employees (i.e, was there a good "tone at the top")?

- Whether the company's public filings remain reliable in light of the information learned, and if not, whether restatement is required (using, among other things, a U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 99 materiality analysis; and

- Whether the investigation revealed material weaknesses or significant deficiencies in the company's internal controls.

Deciding whether and how to document the results of the investigation requires a complex analysis. Drafting a formal report of the investigation is time-consuming and expensive.

Many constituents would prefer a full, detailed report of the information gathered during the investigation and the findings that may ultimately be made public. Others may prefer only oral reports and no public disclosure at all. Whether the ultimate report remains privileged or not depends on the facts and circumstances of the specific investigation, and will require detailed analysis and thoughtful legal advice.

Special Obligations of Independent Auditors

Section 10A of the Securities Exchange Act of 1934 (15 U.S Code Section 78j-1) requires a company's independent auditor to work through a set of detailed procedures if the audit 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 term "illegal act" is very broad, defined as "an act or omission that violates any law, or any rule or regulation having the force of law."

The procedures set forth in Section 10A include:

- Determining whether it is likely that an illegal act has occurred;

- Determining and considering "the possible effect of the illegal act on the financial statements of the issuer";

- Informing "the appropriate level of the management of the issuer and assur[ing] 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 firm's attention "unless the illegal act is clearly inconsequential";

- Determining whether the illegal act has a material effect on the issuer's financial statements; and

- Determining whether senior management (or the board) has taken timely and appropriate remedial actions.

Special — and more serious — procedures are triggered if the audit firm concludes that the company's actions have not been sufficient. Under that circumstance, Section 10A requires that the audit firm determine whether that failure "is reasonably expected to warrant a departure from a standard report of the auditor, when made, or warrant resignation from the audit engagement."

If so, the auditor must report the results of this determination to the board of directors. If this report is made to the board, the issuer must notify the U.S. Securities and Exchange Commission within one business day and provide a copy of this notice to the auditor.

If the auditor does not receive a copy within one business day, the auditor must resign or furnish a copy of its own report to the SEC within one business day. If the auditor resigns under this provision, it must furnish a copy of its own report to the SEC within one business day after resigning.

If these procedures are underway but are not yet complete, the auditor may not be able to complete its quarterly review or its annual audit. And, as the independent auditor, the firm cannot advise the company of the company's obligations — it can only react to what the company does and reach a view as to whether that is sufficient.

This can set up a challenging dynamic in which experienced outside counsel may be especially valuable, particularly when navigating issues related to conveying information and conclusions from an investigation that might be protected by the attorney-client privilege.

When a company conducts an internal investigation that could trigger the auditor's Section 10A obligations, the auditor typically involves individuals from its forensic practice and/or its office of general counsel to advise the audit team.

The final installment of this article will discuss responding to government investigations, and understanding the needs of various constituents during the investigation process.

Dixie L. Johnson, Brandt Leibe and Grant W. Nichols are partners at King & Spalding LLP.

[1] Upjohn Company v. United States, 449 U.S. 383 (1981).