

 **CORPORATE WAVELENGTH**
The Corporate Governance, Risk, and Compliance Web Series

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Multi-State Investigations: Effective and Efficient Strategies

Katherine Combs
EXELON CORPORATION

Lisa L. Tharpe
FOLEY & LARDNER LLP

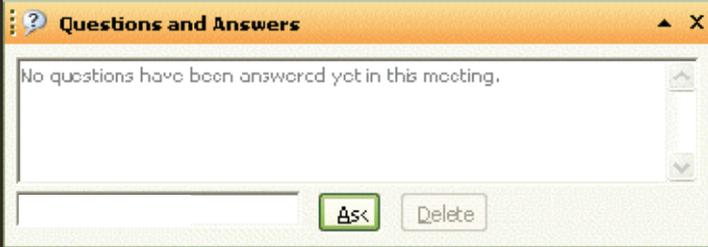
 

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Today's Speaker

Lisa Tharpe
Partner, Foley & Lardner LLP

- Member of the firm's Securities Litigation, Enforcement & Regulation and White Collar Defense & Corporate Compliance Practices.
- Concentrates in corporate litigation, with a primary focus on the representation of parties in the securities and financial services industry.
- Participated in counseling and defending individual members and member firms in connection with proceedings before the SEC, the National Association of Securities Dealers, and state securities regulatory bodies.

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Today's Speaker

Kathy Combs
Senior VP, Governance and Deputy General Counsel and Secretary

- Oversees internal investigations and business conduct oversee all investigations of various sorts per year.
- Responsible for corporate governance and for compliance with the requirements of the SOX and other corporate governance reforms.
- Oversees SEC reporting and disclosure and provides legal counseling on securities laws and regulations.

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Today's Moderator

Brendan Sheehan
Executive Editor, *Corporate Secretary*

- Editorial mission: To provide innovative and insightful analysis for corporate secretaries, general counsel and compliance officers
- *Corporate Secretary* is the leading source of information on matters relating to the SEC, Sarbanes-Oxley, D&O insurance, shareholder communications, proxy solicitation and voting, director education and compensation, listing requirements and entity management

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Summary

- Purpose: Practical considerations for effectively managing and responding to multi-state investigations
 - Considerations based on experience: success and failure
 - Key “practice points” in red
- Agenda for today:
 - Background
 - Preparation and immediate considerations
 - Understanding the unique challenges of multi-state investigations
 - Undertaking an internal investigation
 - Reporting the results of the investigation

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Background: The Emerging Importance of Multi-State Investigations

- A recent, and now established, fact and challenge of corporate life
- Driven in part by highly publicized national and state regulatory investigations, inquiries and actions
- Also driven by:
 - Compliance concerns
 - Employee complaints (internal and “whistle blowers”)
 - Shareholder inquiries
 - Private litigation
 - Customer or vendor complaints

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Important Early Considerations

- **Revamp supervisory systems and procedures to ensure they are as robust and thorough as possible**
 - Encourages a culture of compliance
 - Helps the institution to best position itself with regulators
- **Standardize internal investigation procedures on a regional/national level**
 - Standardize procedures among relevant departments: internal audit, legal, security/risk; also consider sharing with outside counsel
 - Coordinate responses to investigations to ensure responses are consistent

Live Meeting Poll

Polling Question #1

How many of you have standardized internal investigations procedures across all offices and departments?

- **My company does**
- **My company does not**

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Important Early Considerations

- **Commitment and support of senior management**
 - Explaining the investigation to revenue generators
 - Addressing resistance
 - Written authorization and directions
 - Investigative team must have real authority
- **Coordination between investigative team and senior management**
 - **Involvement in decisions related to the investigation**
 - Termination of employment decisions
 - Government filings
 - Press releases

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Important Early Considerations

- Speed is of the essence!
- Stop the improper conduct!
- Assuring retention of documents and electronic information
 - Suspension of standard retention policies: hard copy and electronic
 - Delivering a strong, written directive
 - Securing documents and electronic information that might be in jeopardy

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Important Early Considerations

- Documenting the steps of the investigation
 - By leadership of the investigative team
 - By members of the team
- Preparing a chronology of facts
- Interim reports to senior management
 - Moves investigation forward
 - Keeps senior management informed for purposes of assessing scope of investigation and making interim decisions

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Important Early Considerations

- Establishing the tone of the investigation
 - Avoiding the appearance of a “witch hunt”
 - Avoiding undue morale problems
 - Avoiding inappropriate employee communications
 - Proper instructions
 - The problem of shared recollection

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Preparing for the Investigation

- Selecting an internal investigative team
 - Establishing an investigative and reporting hierarchy
 - In-house attorneys, compliance, human resources
- Retaining outside counsel
 - Importance to create appearance of independence
 - Credibility is Key: Knowledge of and experience with relevant state regulator
 - Company liaison with outside counsel
- Retaining third party experts
 - Formal engagement letter
 - Accountants or audit firm
 - Which accountants or audit firm?
 - E-mail and technology services
 - Engage as early as possible

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Unique Challenges of Multi-State Investigations: National or Regional Coordination

- Many state regulators or attorneys general have formed national organizations or joint task forces
 - Eg. North American Securities Administrators Association (“NASAA”) at www.nasaa.org
- Allows state regulators to share information about:
 - Emerging problems or causes for concern in their respective states or industries
 - Results of their respective investigations
 - Strategies for pursuing investigations

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Unique Challenges of Multi-State Investigations: National or Regional Coordination

- **Practice Pointer:** Institutions should also consider national or regional coordination
 - Informal Networks
 - Formed by members of same or similar industries
 - Check-in informally on a monthly or quarterly basis
 - Share subjects or status of recent state inquiries
 - Formal Defense Groups
 - Formed by group of institutions that have received the same or similar inquiries from state regulators
 - Meet on a regular basis to share subjects of inquiries, coordinate responses

Live Meeting Poll

Polling Question #2

How many of you have joined (either directly or through outside counsel) a joint defense group in connection with responding to a state investigation?

- **My company does**
- **My company does not**

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Unique Challenges of Multi-State Investigations: National or Regional Coordination

- Benefits of Formal or Informal Coordination
 - May receive advanced notice of an investigation, greater lead time to identify and prepare a response
 - Larger numbers of respondents permits greater leverage reductions in scope, extensions of time
 - Larger number of respondents also allows institutions to negotiate settlements, when and if the investigation should result in a settlement, from a position of strength
 - Important to consider if the resolution sought by the regulator may significantly alter the landscape of a particular industry
 - Eg. Equity Indexed Annuities

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Unique Challenges of Multi-State Investigations: National or Regional Coordination

- Possible detriment to coordinating among institutions
 - Guilt by association
 - Some members of the industry may be much more involved in alleged wrongful conduct than others
 - Make sure you position your institution with those that are similarly situated – often difficult to know
 - May inhibit a quick resolution of the investigation
 - Once an respondent joins a joint defense group, it is often difficult to separate again
 - Generally, joint defense groups slow down the investigation
 - **Practice Pointer:** Consider joining a formal joint defense group only if you believe that your institution has substantial exposure.

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Unique Motivations of Multi-State Investigations: Role of Publicity

- Publicity as a weapon to bring institutions to the settlement table
 - Fear of bad publicity, being seen as a bad company
 - Most important to institutions with retail business, dealing directly with consumers
 - May lead to filing of class action lawsuits
- Publicity as campaigning
 - Many state regulators/attorneys general have greater career aspirations
 - Will be more motivate to extract a larger settlement and to publish the settlement



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Unique Motivations of Multi-State Investigations: Role of Publicity

- Practice Pointers: For those institutions that seek to minimize negative publicity
 - Get out in front of investigation early
 - Learn about subject of investigation as early as possible
 - Hire outside counsel with good relationship with state regulator
 - Complete thorough internal investigation and share results with the state regulator
 - Identify single individual responsible for responding to press inquiries
 - Consider developing public relations strategy for responding to negative publicity: proceed with caution
 - Propose unique solutions that reduce individual role
 - Global settlement announcement that includes all respondents settling a particular investigation

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Unique Motivations of Multi-State Investigations: Financial Motivations

- State regulators benefit more directly from large fines
 - Fines imposed by state regulators flow into the states' general fund
 - May have a direct impact on budgets, salaries, etc.
 - Contrasts with federal regulators
- Fines vs. restitution: Practice Pointers
 - Restitution is aimed reimbursing customers and therefore can be presented as a "higher goal"
 - Institutions may obtain tax benefits from payment of restitution; no tax benefit from fines
 - Institutions may also obtain offset for pending or future class action lawsuits

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Conducting The Investigation

- Collection of Documentation and Information
 - Identification of sources of information
 - Identification of types of information
 - Identification of location of information
- Collection and review of documents
 - By corporate personnel
 - By proper members of investigative team
 - Documents should flow through counsel (try to maintain privileges)
 - Cross-checking sources, drafts, etc.
- Keeping a detailed search and review log
- Loading into, and searching in, electronic format

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Conducting The Investigation

- The importance and challenges of e-mail and electronic information
 - Identification of sources
 - Individuals
 - Data storage
 - Prevention of automatic deletion or overwriting
- Collection
 - Utilization of in-house technology
 - Outside expertise
- Additional records to preserve and gather
 - Calendars (hard copy and electronic)
 - Hand-held electronic devices
 - Telephone records

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Conducting the Investigation

- Interviews of Witnesses
 - Setting the interview schedule/Working “up the ladder”
- Conducting the interviews
 - Attendees: Including a representative of the company
 - **Initial disclosures**
 - Outlines and notes
- Interview memorandum
 - Contents
 - Distribution
- **Cross-checking and follow-up interviews**
- Additional considerations
 - Counsel for the interviewee
 - Handling the hostile or reluctant interviewee
 - Interviewing senior level management
 - Witnesses contacted directly by the government

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Collection of Information From Third Parties

- Proceed with utmost caution
- Identifying sources of information
 - Former employees
- Considerations in requesting information
 - **Proper approach by proper company representative**
 - Type of information being sought
 - Disclosure of potential issues and existence of investigation
 - Compromising privilege protection
 - Whether the investigation will be comprehensive without the information
- **Begin formulating strategy early**
 - Maximizes options
 - **Reduces “being at the mercy” of third party**

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Findings of the Internal Investigation

- Reporting to senior management
 - Recipients of the report
 - Contents of the report
- Preparation of a written report
 - Considerations
 - Content
 - Distribution

Live Meeting Poll

Polling Question #3

How many of you have shared the written results of internal investigations with state regulators?

- **My company does**
- **My company does not**

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Action in Light of the Investigation

- Remedial action must be proper and prompt
- Remedial internal action
 - Revised corporate procedures
 - Revised corporate structure
 - Revised compliance procedures or oversight
 - Employee disciplinary action
- Remedial external action
 - Disclosures in public filings
 - Compensating injured third parties

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Sharing Results of the Internal Investigation

- Sharing the report with the government
 - Pre-investigation: May minimize or preclude an investigation
 - Minimizing adverse consequences of a government investigation or action
- Ramifications of sharing the report
 - Waiver of privileges (McNulty Memo, revising Thompson memo)
 - Steps to minimize
 - No guarantee of protection
 - Identification of wrongdoers
 - Identification of sources
 - Circulation beyond the company's control
 - Possible criminal implications

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The Ramifications of an Incomplete or Negligent Investigation

- Will precipitate full blown government investigation and sanctions
 - Loss of credibility going forward
- Provides no cover in private litigation
- Future misconduct possible
- Waste of corporate assets

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Final Thoughts

- Importance of Coordination: Among departments, offices, and throughout industry
- Speed is of the essence
- Sensitivity to unique motivations of state regulators: publicity, greater political ambitions, financial motivations
- Consider ramifications of sharing results of investigation with the state investigators: waiver of privilege for other inquiries and possible private litigation
- Always consider possible criminal consequences



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Thank you for your participation

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