
Business Litigation 2010:
Unlocking Successful Strategies
for Wisconsin Companies
Internal Investigations 2010:
Maximizing Efficiency Without
Minimizing Effectiveness
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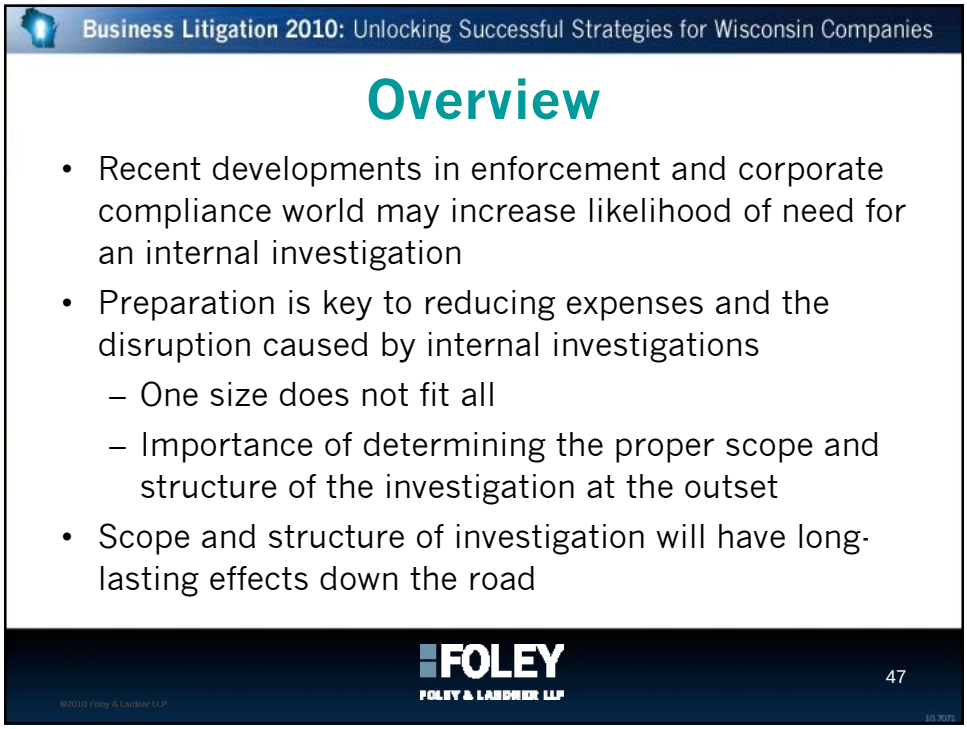
Business Litigation 2010: Unlocking Successful Strategies for Wisconsin Companies
Overview
• Recent developments in enforcement and corporate compliance world may increase likelihood of need for an internal investigation
• Preparation is key to reducing expenses and the disruption caused by internal investigations
– One size does not fit all
– Importance of determining the proper scope and structure of the investigation at the outset
• Scope and structure of investigation will have long-lasting effects down the road
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What's New?

- "We've gotten some high-quality tips."
  - SEC official Stephen Cohen.
- "It's not only a different ballpark, it's an entirely different galaxy."
  - Plaintiffs' lawyer Erika Cohen of Phillips & Cohen.
- "In the last three weeks, I've had many more whistle-blowing calls than I had in the last three years."
  - Plaintiffs' lawyer Rebecca Katz of Bernstein Liebhard.

What's New?

- Dodd-Frank Whistleblower Provisions (Section 922)
  - SEC "shall" award whistleblowers between 10% and 30% of any monetary recovery in excess of $1 million
  - Recovery in "related proceedings" (*e.g.*, actions brought by DOJ, state AGs, self-regulatory agencies, other regulatory authorities)
  - Few exceptions (*e.g.*, those convicted of criminal violations, certain government employees and auditors)
- SEC's New Cooperation Policy (January 2010)
  - Cooperator's assistance must be "substantial" and "reliable"
  - Cooperation especially rewarded for "priority matters or serious, ongoing or widespread violations"
  - New tools include "proffer" agreements and deferred prosecution agreements

What's New?

- Civil Investigative Demand (CID)
  - March 2010: DOJ authorizes all U.S. Attorneys to issue CIDs in connection with False Claims Act investigations
  - Powerful investigative tool; allows government to obtain documents, oral testimony, and interrogatory responses before deciding whether to commence formal litigation
- "Piggy-back" investigations; industry-wide "sweeps"
- "Fraud Triangle" in difficult economic times:
  - (1) financial pressure
  - (2) opportunity
  - (3) rationalization

Decision to Conduct an Investigation

- Affirmative obligation for some regulated entities to report misconduct and risk-exposure issues
  - FINRA/NYSE rules
  - Section 10A of '34 Act requires action if auditor believes "an illegal act" has occurred
  - Section 307 of SOX requires action if attorney reports a material violation of federal securities laws
- Corporate due diligence; fiduciary obligations
  - Management and board obligated to take action when confronted with significant risk exposures; derivative allegations
  - Fostering culture of compliance; "right thing to do"

Structuring the Investigation

- Establishing the proper structure is critical to the success of an investigation
  - "The injury to a company from a poorly structured or executed investigation can be substantial; when regulators of enforcement authorities ultimately develop the full story, the company's credibility will be injured, its attempt to claim credit for cooperation will be jeopardized, and the surprise to shareholders and other can further damage the company's reputation."
    - Giovanni Prezioso, SEC General Counsel, Remarks to the Vanderbilt Director's College (Sept. 23, 2004).

Structuring the Investigation

- Unlike traditional litigation, internal investigations:
  - Develop very quickly; no notice
  - Require immediate action
  - Do not have clearly established deadlines (*i.e.*, no scheduling orders)
- Premium is placed on conducting efficient and effective internal investigations on short notice
  - Particularly to avoid a potential "race to the regulator" with a whistleblower

Who Should Investigate?

- HR, internal audit, and/or compliance officer
  - Routine matters involving minimal risk to the company
- Involvement of in-house counsel
  - Investigation into activities of lower-level employees
  - Low risk of civil liability or litigation
  - Isolated and well-defined allegations
  - Additional protection of attorney/client privileges
    - BUT be mindful of "business hat" issues
  - Appearance of independence; no connection to allegations
- Importance of delegation memo

Who Should Investigate?

- Involvement of outside counsel
  - Need for additional expertise, experience, or resources
  - Need for independent review; consider audiences
  - Additional safeguarding of attorney/client privilege
  - Risk of criminal or significant civil exposure
  - Allegations implicate key strategic initiatives
  - Inquiries from government agencies or regulators
  - Allegations of wrongdoing by key competitors
  - Investigations into activities of management or senior employees

Who Should Monitor?

- Consider scope of investigation and company structure
  - Office of General Counsel: A good choice for most investigations
  - Audit Committee: Often preferable when allegations relate to senior management; additional powers granted to Audit Committees under SOX § 301
  - Special Committee: Preferred choice when allegations might impact the board or in the context of a derivative action

Defining The Scope

- Crucial to determine the proper scope of an investigation at the outset
- Requires balancing many factors, including cost
  - Who is the immediate audience? Potential audiences?
  - What is the precise issue being investigated? Where does the investigation "stop"?
  - Focus on known issues or identified employees? Or expand to include similarly situated employees?
  - How can we control costs and prevent the investigation from running amok?

Defining The Scope

- Consider company policies and procedures
  - Strength and breadth of the company's current compliance policies and procedures may inform the scope of the investigation
  - Always ask witnesses about compliance with policies and procedures; discuss training received
- Be flexible and reassess scope when necessary
  - Consider middle-ground, "build-up" approach
  - Sampling techniques (*e.g.*, products, personnel, geographies)

Defining The Scope

- Preparing a budget is a difficult but necessary task
  - Especially when investigating multiple or imprecise allegations of wrongdoing; responding to general requests for information from government agencies (*i.e.*, reading the tea leaves)
- Regular communication avoids surprises
  - Budgets should be adequate to maintain investigation standards or to permit a necessary expansion of scope
  - Consider budgeting and revisiting budget by phases; conducting preliminary investigation to understand scope (time permitting)
  - Experts can affect investigation costs significantly (*e.g.*, forensic accountants; forensic computer analysts)

Collecting Data & Documents

- Critical to understand IT systems
  - Suspension of data destruction or recycling policies
- Collection depends on scope of investigation
  - Document hold letters
  - Identification of custodians; "custodian interviews"
  - Formulate search criteria to focus investigation (*e.g.*, key terms, date ranges, custodians, clients, transactions)
- Data/document collection
  - Outside vendors: Often required for large-volume document cases
  - Document collection programs: Cost effective solution for targeted investigations (*e.g.*, SafeCopy2)

Collecting Data & Documents

- Document review – cost versus thoroughness
  - Attorney review: expensive but effective
    - Consider contract attorneys for initial review
    - Document review firms if litigation expected (*e.g.*, NovusLaw)
  - Extensive use of technology
    - Searchable/OCR-enabled databases
    - Sorting by metadata
    - "Conceptual" searching tools
- Critical to memorialize document collection and review processes
  - Involve government/regulators if necessary to propose search terms or parameters

Conducting Interviews

- Best practices (general)
  - Provide "*Upjohn* Warnings"
  - Understand basic issues raised by allegations; if time sensitive, use early interviews of secondary witnesses to develop foundational knowledge and refine scope of investigation
  - Two-person interviews; allows for accurate note-taking; provides second witness to interviewee statements
  - Exhaustion of memory before reviewing documents
  - Request that interviewees maintain confidentiality of conversation
  - Typically, primary alleged wrongdoer(s) should be interviewed last

Conducting Interviews

- Issuance of "*Upjohn* Warning"
  - Increasingly critical as government steps up enforcement efforts and companies consider disclosure
  - The warning:
    - confirms the investigators represents the Company, not the witness;
    - that the Company controls the privilege; and therefore
    - the Company can decide what to do with the information obtained.
- Common questions from interviewees:
  - Am I in trouble? Do I need a lawyer? What if I don't cooperate?
- Providing counsel to witnesses
  - May be required by Company bylaws or policies; advisable in other cases
  - Consider separate counsel to avoid conflict of interest allegation
  - Consider "group counsel" for witnesses to reduce costs

Protecting Privileges

- Investigations by counsel generally privileged
  - *See Upjohn Co v. U.S.*, 383 (1981) (if an attorney is acting on behalf of the company, the privilege can be maintained for communications with employees)
- In U.S., privilege typically applies to both in-house counsel and outside counsel
  - Note that European Union does not extend the privilege to communications with in-house counsel. *See Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd v Commission* (Case C-550/07 P) (Sept. 14, 2010).
- Underlying facts discovered in investigation are not privileged

Protecting Privileges

- Investigation for business purposes may *not* be covered by attorney-client and work product protections
  - *See SEC v. Microtune*, 258 F.R.D. 310 (N.D. Tex. 2009) (documents prepared for business purposes including ratifying misdated options, developing better corporate practices and restating financial results).
- Company risks losing control of privilege if information conveyed during course of investigation is mishandled.
  - *See U.S. v. Nicholas*, 606 F. Supp. 2d 1109, *rev'd.*, *U.S. v. Ruehle*, 583 F.3d 600 (9th Cir. 2009).

Disclosing Investigation Results

- The Auditor
  - Auditors may demand full disclosure; may insist that additional work be performed
  - Failure to disclose may delay receipt of audit opinion
  - Sharing information with the auditor risks attorney-client privilege and work product waiver
    - *Compare Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002) (sharing information with auditor resulted in waiver of attorney-client privilege and work product protections) with *Merrill Lynch & Co., Inc. v. Allegheny Energy*, 229 F.R.D. 441 (S.D.N.Y. 2004) (no waiver because Merrill Lynch and its auditor were not "adversaries"). No waiver seems to be the predominant view, although the result may depend on the particular facts and circumstances. *See U.S. v. Deloitte LLP*, __ F.3d __ (D.C. Cir. June 29, 2010)

Disclosing Investigation Results

- The Board of Directors
  - Whether/how the board should be informed depends on the circumstances
    - Sharing information with board can result in waiver where board is not the "client." *Compare SEC v. Roberts*, 254 F.R.D. 371 (N.D. Cal. 2008) (where counsel engaged by Special Committee, the board was not the client and no "common interest" existed between the board and Special Committee); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 244 F.R.D. 412 (N.D. Ill. 2006) (while Audit Committee retained counsel, the "client" was the entire corporation).
    - Where the conduct of board members is at issue, communications to those directors will waive privilege. *See Ryan v. Gifford*, 2008 WL 43699 (De. Ch. Feb. 6, 2007) (involving Special Committee report to directors regarding investigation of stock option backdating).

Disclosing Investigation Results

- The Government/Regulators
  - Consider reporting obligations under federal securities laws or other regulations
  - Case-by-case analysis, but commentators predict more disclosure in light of Dodd-Frank
  - SEC's 2001 "Seaboard Report": Production of internal investigation report is a factor to be considered in assessing cooperation
    - SEC's 2006 "Statement on Penalties" identified "self-reporting" and "timely remediation" as key factors in assessing corporate penalties (if any)
  - DOJ guidelines: "timely disclosure of wrongdoing and a willingness to cooperate" should be considered in charging decisions

Disclosing Investigation Results

- The Government/Regulators
  - Key questions
    - Does the government already know? Is eventual disclosure likely?
    - Can disclosure be limited?
    - Is litigation pending or lurking in which waiver could be costly?
    - Does disclosure risk defamation or other tort claims from individuals subject to the investigation?
      - *See Roberts v. McAfee*, 09-04303 (N.D. Cal. Sept. 16, 2009) (lawsuit by former general counsel for defamation and "scapegoating").
  - In most cases, disclosure to the government will result in waiver of privilege and work product
    - Caselaw in flux

Disclosing Investigation Results

- Written Report?
  - In some cases, written report required (*e.g.*, reliance on investigation results to dismiss derivative litigation)
  - Written report not always necessary or advisable (*e.g.*, potential for litigation)
  - Consider oral report or PowerPoint presentation to reduce risk of privilege waiver
  - Consider whether report should include legal conclusions or only factual observations
    - Should be balanced (*i.e.*, negative and positive information)
  - Personnel actions or changes in policies and procedures resulting from investigation should be documented.

Take Aways

- Preparation at the outset is key to an efficient and effective investigation
  - Focus on structure before jumping into investigation
  - Be cognizant of "race to the regulator"
- A narrow (but credible) scope is fine, but be flexible and reassess
- Many technologies and techniques can help manage costs
- Once privileged is waived, it is waived forever