

Internal Investigations

2008 NATIONAL DIRECTORS INSTITUTE



INTERNAL INVESTIGATIONS

INTRODUCTION

“Internal Investigations” was a featured breakout session at the seventh annual National Directors Institute hosted by Foley & Lardner LLP on March 6, 2008, in Chicago. The session was moderated by Bryan B. House of Foley and Robert Huff of Aon Consulting. Panelists were Kirk G. Forrest of Minerals Technologies, Inc.; Dawson Horn III of Altria Corporate Services, Inc.; Amy Jones of McDonald’s Corporation; Jonathon Crook of Eversheds LLP; and Scott I. Shaffer of Deloitte Financial Advisory Services LLP.

ONE SIZE DOES NOT FIT ALL

Internal investigations come in all shapes and sizes, and they come from many sources. Not all investigations will rise to the level requiring that the general counsel be involved. Often, there may be small matters that rise through the internal audit function in the ordinary course. It is important, however, that the internal audit group has a reporting role to the general counsel (or the chief compliance officer, if the company has such a position). The internal audit function also should have a direct line to the audit committee. Other investigations may come through the company’s “hotline,” and still others regarding minor employee misconduct may be led by the human resources department.

It is not efficient or necessary for the general counsel to be involved in all these types of investigations. There should, however, be a mechanism that would allow these types of investigations to be elevated to the level of the general counsel if the discovered facts warrant such action. If the initial reported issue has an impact on a company’s financial statements, senior management’s credibility, or the company’s reputation generally, it becomes a “big ticket” item and the general counsel needs to play a central coordinating role from the outset.

BIG TICKET INVESTIGATIONS AND PRIVILEGE

Well before a big ticket investigation ever commences, it is important to be properly prepared for such an endeavor. While not all investigations will require outside assistance, a general counsel should have a short list of “go-to” law firms and consultants for these types of matters before they arise. Once the investigation has been initiated, the general counsel or a designee must ensure the proper and efficient flow of information within the company. One of the most important reasons for this centralization of control relates to maintaining the attorney-client privilege to the



extent possible.¹ The protection of privilege will require all communications and actions to be filtered through the office of the general counsel or through the general counsel. The general counsel also may consider hiring consultants and experts directly rather than allowing an outside law firm to do the hiring.

In furtherance of this paramount objective, it may be necessary to also limit the amount and type of information that is communicated to the board of directors and the executive officers.² This may be a fine line to toe, as it is important to limit the exposure of the board and officers, but the general counsel should keep each adequately informed so as to not surprise either with the progress or results of the investigation. A general rule to be followed during all internal investigations: All vital and potentially damaging communication within the company should be conducted orally, with two lines of communication open at all times, one to the general counsel and one to the CEO. If the CEO or other executive officers are implicated in wrongdoing, this could alter the reporting process and require that the general counsel communicate directly with the chairman of the audit committee, for example.

The involvement of government regulators makes privilege decisions much more difficult. To be viewed as cooperative, companies often feel they must waive privilege. In late 2006, Deputy Attorney General Paul McNulty issued a memorandum setting forth additional guidance on the doctrine of attorney-client privilege and the work product doctrine, “one of the oldest and most sacrosanct privileges under U.S. law,” and noted that the waiver of the corporate attorney-client privilege is not a prerequisite to finding that a company has cooperated in a government investigation.³ This memo was a step back from an earlier, harsher position suggesting that refusal to waive privilege could lead the government to view the company negatively. The privilege waiver issue often arises in the context of U.S. Securities and Exchange Commission (SEC) investigations when a company wants to disclose the results of its internal investigation to the SEC in an effort to avoid or limit SEC charges. The law, at least in most jurisdictions, rejects the

¹ The company must give special and expert attention to the preservation of the privilege in international matters. In such cases, it may be important to have local counsel who understand the privilege issues and can communicate them effectively to the overseas employees and company officials.

² For more information on the doctrine of corporate privilege, please see *Ryan v. Gifford*, 2008 WL 43699 (Del. Ch. Jan. 2, 2008), which held that the company waived its corporate privilege when the special committee presented its findings to the board of directors while the director defendants were in attendance, along with their personal outside counsel, at the board meeting in their individual, not fiduciary, capacities along with their personal outside counsel.

³ The McNulty Memorandum, issued December 12, 2006, softens the inflammatory guidance resulting from the previous two memoranda discussing the attorney-client privilege. The McNulty Memorandum sets forth the requirements to which investigators and prosecutors must adhere when investigating a matter. The standard for requiring disclosure of privileged material: “[T]here is a legitimate need for privileged information to fulfill their law enforcement obligations.” The memorandum can be read in its entirety at http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf.



doctrine of “selective waiver” and holds that privilege as to those materials (or even the entire subject matter) has been waived.⁴

OUTSIDE EXPERTS AND CONSULTANTS

When dealing with intensive, closely monitored inquiries by government or regulating authorities, companies should consider hiring outside specialized legal counsel as well as a sophisticated accounting firm to ensure that the matter is handled properly and thoroughly. It is important to trust the competency, professionalism, and fiscal responsibility of the outside experts. Although it is important to contain and monitor the costs of such outside advisers during an internal investigation, it is equally important to keep the costs in perspective relative to the greater picture and potential ramifications of a negative result.

At the commencement of the investigation, it is important to the sanctity of the examination to preserve the relevant data within the company. This can be accomplished in two main ways. First, it is important for the company to have a proper and comprehensive electronic document retention policy. The company should build on that policy to institute a legal hold for all company employees with respect to any documents that may be relevant to the investigation. This is becoming increasingly important as courts are becoming much more willing to penalize companies that improperly handle the preservation of electronic documents. A company’s in-house information technology staff will be critical to this effort. Second, conducting employee interviews as soon as possible after the commencement of the investigation also can preserve the mental impressions and verbal communications necessary to the completion of the investigation.

While companies should use consultants and experts for document collection and analysis when necessary, there are ways to control costs. The key is proper “scoping” of the work the consultants will do. General counsel should demand a work plan from these kinds of consultants, and the general counsel should have regular meetings or conference calls with the consultants to follow the progress being made. Because internal investigations often are dynamic, it may be necessary to change the work plan; regular communication should help prevent unwelcome surprises.

CONFLICTS WITH THE COMPANY’S AUDITOR

The company may want to retain specialized accounting experts for matters relating to complicated financial matters. Retention of an independent accounting firm for a specific “deep-dive” audit often is necessary to truly understand a matter and to keep it cloaked in legal

⁴ For more information on the doctrine of selective waiver and proposals to codify the doctrine, please see proposed Rule 502 to the Federal Rules of Evidence and *In re Initial Public Offering Securities Litigation*, 2008 WL 400933 (S.D.N.Y., Feb. 14, 2008).



privilege. In these complicated financial investigations, it is not wise to use the company's regular auditor — for at least two reasons. First, very often these investigations will raise questions regarding what the auditors knew and when they knew it. Therefore, the regular auditor's conflict of interest would seem to preclude that auditor from assisting in the investigation. Second, there typically is no legal privilege between a company and its regular auditor, so the company should hire outside experts to maintain privilege. Both of these issues are complicated because the auditor often will want to know what the company has found in course of the investigation and whether it can continue to rely on management and/or the previously issued financial statements.

Again, communication is key. Counsel and/or the consulting experts may need to regularly update the auditor regarding the progress of the investigation. To maintain privilege to the extent possible, these conversations should be oral. This is particularly true because the company may have to disclose potentially damaging facts in these communications.

FOR MORE INFORMATION

For more information on this session or the seventh annual National Directors Institute, visit Foley.com/ndi or contact the moderators and panelists directly.

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