Internal Investigations

Best Practices

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Introduction

Organizations conduct internal investigations when confronted with significant legal and financial risks. A successful internal investigation follows recognized best practices. Spencer Fane LLP presents this best practices information to inside counsel. It is based on Spencer Fane's experience in conducting internal investigations, and on case law, ethics rules and the experience of other law firms. We believe this is a valuable resource that will support inside counsel's oversight and decisions in internal investigations.

About the Author

Mark Thornhill represents individuals and organizations in white collar criminal and regulatory cases. His white collar work started as a prosecutor with the United States Department of Justice - Criminal Tax Section. At Spencer Fane, Mark has defended the full array of white collar cases - anti-trust, bank fraud, computer fraud, environmental, healthcare, mail fraud/wire fraud and tax evasion, among others. In regulatory cases, Mark has represented individuals and companies before the Securities and Exchange Commission, the Financial Institutions Regulatory Authority (FINRA), the Public Company Accounting Oversight Board (PCAOB), the Federal Reserve Bank and the Environmental Protection Agency.

Mark has an active practice in internal investigations. In an investigation for a large Midwest bank, Mark uncovered more than $1 million in fraudulent transactions by the bank president. Mark's investigation for an IT company revealed more than $200,000 in unauthorized payments to the CEO. Mark investigated allegations of corruption in connection with medical research grants and in connection with the pricing of securities. Mark recently worked with the National Institute for Trial Advocacy to develop an internal investigation instructional program.

When to Conduct an Internal Investigation

Internal investigations are conducted when an organization confronts significant potential liability arising from conduct that is not fully understood by management. The internal investigation is conducted to determine if the conduct actually occurred, its scope and the persons responsible. Through the internal investigation, the organization may identify corrective actions it should undertake. These may include difficult negotiations with government agencies, significant changes in corporate governance and actions against high-level employees.

Internal investigations are conducted in various contexts. Often the potential liability is within the jurisdiction of a prosecutor or a regulator. Investigations that focus on potential criminal or regulatory liability are commonly known as “government investigations”. Government investigations frequently are in the news as prosecutors focus on how companies operate and how they report financial results. Sometimes, the potential liability is within the jurisdiction of a self-regulatory body such as FINRA or the NCAA. The potential liability also may be to customers. For example, data breaches that threaten the security of customer records are a frequent reason for internal investigations. In these investigations, the organization faces liability even though it is also a victim of a cyber-attack. In each of these situations, the organization seeks to identify the root causes of the potential liability and the best remedy.

Who Conducts the Internal Investigation

Outside counsel should conduct the internal investigation in most cases. Outside counsel generally are selected because they provide specialized expertise which is critical to the investigation. The outside legal team always should include a subject matter expert who is conversant with the substantive legal issues and the business procedures that are at the core of the investigation. In the case of a government investigation, the outside legal team should be led by an experienced white-collar defense lawyer. These lawyers understand the intricacies of criminal statutes that may be involved and they are skilled at gathering evidence. Also, these lawyers have relationships or good reputations with the prosecutor or regulator who will decide whether the organization's conduct is blameworthy and, if so, whether any sanction should be modest or severe. A white collar defense lawyer is recommended even if the organization believes the government is pursuing only a civil resolution. This is because the same facts can support a civil or criminal case. The government's civil trial lawyer can refer the case to criminal trial counterparts as the investigation proceeds.

An organization's inside counsel generally should not conduct internal investigations. The most important reason for this general rule is the risk that part or all of the investigation will not be covered by the attorney-client privilege and work product protection. Certainly, investigations conducted by inside counsel may be covered by the privilege. This is part of the Supreme Court's decision in *Upjohn Company v. United States*, 449 U.S. 383 (1981). Nevertheless, courts sometimes are reluctant to conclude that a primary purpose of investigations conducted by inside counsel is legal advice rather than non-privileged business advice. *See e.g.*, *RBS Citizens, N.A. v. Husain*, 291 F.R.D. 209, 217 (N.D. Ill. 2013) *citing Acosta v. Target Corp.*, 281 F.R.D. 314, 322 (N.D. Ill. 2012); *Allied Irish Banks p.l.c. v. Bank of America N.A.*, 240 F.R.D. 96, 104 (S.D.N.Y. 2007); *ABB Kent-Taylor, Inc. v. Stallings and Co., Inc.*, 172 F.R.D. 53, 55 (W.D.N.Y. 1996); *cf.*, *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754, 760 (D.C. Cir. 2014) (reversing district court, stating applicable legal standard and supporting the rule stated in *Upjohn*.).

There are other reasons inside counsel generally should not conduct the investigation. Inside counsel may not have the necessary subject-matter expertise or the time required to devote to research, document review, and other tasks that contribute to the final result. Also, the internal investigation may be the first step toward defending against an indictment or a civil enforcement case. The organization would rely on outside counsel to defend against the criminal or civil claim, so it is sensible to engage outside counsel from the start. Finally, inside counsel may be subject to acute pressure on his independence and objectivity. The investigation may focus on executive colleagues who are friends or on superiors who have power over the inside counsel. In either

circumstance, it can be difficult for inside counsel to direct action that is in the organization's interest but may be adverse to a fellow employee.

There are circumstances in which inside counsel is the most appropriate lawyer to conduct the internal investigation. This is particularly the case when inside counsel has the required subject matter expertise and when inside counsel's work could not be compromised by relationships with implicated employees.

Inside counsel should have an important role in the investigation even when not serving as its leader. Inside counsel should be the liaison between outside counsel and company executives who need to understand the investigation issues. Of course, inside counsel's knowledge of the organization's operations will be of great value.

The organization should not look to an accounting firm or consulting firm to conduct the internal investigation. These firms have broad expertise but they are not lawyers and their work is not subject to the attorney-client privilege or work product protection. Privilege is a key aspect of most internal investigations. Accordingly, accounting or consulting professionals should not serve as investigation leaders, except in the most unusual circumstances where confidentiality is not a goal. *See*, *In re Grand Jury Subpoena*, 599 F.2d 504, 510-11 (2d Cir. 1979); *Allied Irish Banks p.l.c.*, 240 F.R.D. at 104-05. Accountants and other consultants may have an important role, but only as assistants working for, and engaged by, outside counsel.

Oversight by Company Executives

At least one organization executive will be "in the room" throughout the internal investigation. Cooper, "Guideposts for Handling Corporate Investigations", Litigation p. 30, 31 (Spring 2015). This executive (who might be a board member) will be regularly briefed on the progress of the investigation. The executive's role is different than inside counsel's, as the executive is responsible for important business decisions arising from the findings of the investigation.

The executive in the room cannot be someone who is implicated in the conduct under investigation. "Implication" is a broad concept. An executive who took action on the issue under investigation may be implicated. Also, an executive who failed to take action although aware of the issue may be implicated. The integrity of the internal investigation could be undermined if the executive in the room is implicated.

Controlling the Message

The internal investigation is a confidential matter of the organization. ABA Model Rule 1.6 requires that counsel maintain that confidence. Counsel are authorized by the same rule to disclose the matter under investigation to the extent reasonably necessary to obtain information. Counsel may disclose the matter more broadly if so directed by the organization. Obviously, the matter under investigation needs to be revealed in some detail to employees who are identified for an interview and to custodians of documents that are to be preserved. But counsel must avoid unnecessary disclosures of information learned in the investigation. Wholesale disclosures could cause a privilege waiver.

The fact of an internal investigation may become well-known to employees throughout the organization. This is especially likely if the investigation centers on persons who are prominent in the organization. Counsel should consider a statement to employees that acknowledges the investigation, presents a general description of the matter being investigated and affirms the organization's commitment to compliance with law and regulation.

Information Collection and Retention

Counsel cannot conduct an adequate investigation without careful review of all relevant information, in electronic and hard copy format. This is obvious. But counsel must also be alert to document retention obligations. The famous *Zubulake* cases held that an organization has a duty to preserve relevant information from the time that litigation is reasonably anticipated. *Zubulake v. UBS Warburg*, 220 F.R.D. 212, 218 (S.D.N.Y. 2003) (Zubulake IV); *Zubulake v. UBS Warburg*, 229 F.R.D. 422, 431 (S.D.N.Y. 2004) (Zubulake V). This obligation now is explicit in the Federal Rules of Civil Procedure. Rule 26(f)(2), (3) and Advisory Committee Notes, 2006 amendment; Rule 34(b)(2) and Advisory Committee Notes, 2015 amendment; Rule 37(e) and Advisory Committee Notes, 2015 amendment. Civil litigation is "reasonably anticipated" in connection with the subject of many internal investigations, so the preservation obligation should be presumed to apply.

The obligation to identify and preserve information also exists if counsel is investigating a possible criminal law violation. The Federal Rules of Criminal Procedure do not address information retention; however, a federal obstruction of justice statute creates a felony crime for altering, destroying or concealing information for the purpose of impeding or influencing any existing or contemplated investigation. 18 U.S.C. § 1519; see also, 18 U.S.C. § 1518 (regarding healthcare investigations); 18 U.S.C. § 1517 (regarding financial institution investigations). Commentators believe the obstruction of justice statute extends the preservation rules to investigations of an organization's criminal conduct. The Status of Criminal Justice 2014, Chpt. 7 (J. Murphy and L. Marion) "E-Discovery In Government Investigations and Criminal Litigation," ABA (2014).

Counsel should hire an electronic discovery consultant in virtually all internal investigations.[1] Without expert assistance there is too great a risk of losing information because counsel did not ask the right questions of the organization's IT manager. Also, hiring a consultant brings additional confidentiality to the process. This is particularly important in government investigations. Counsel's consultant is not likely to be subpoenaed to a grand jury or deposition for testimony about his work. By contrast, the organization's IT manager may be subpoenaed and questions will be asked about his work. Communications and actions by the IT manager taken at counsel's request will be protected by the attorney-client privilege and the work product immunity, but facts learned by the IT manager will not be protected by the privilege or the immunity and will be legitimate topics for testimony. See, Restatement (Third) The Law Governing Lawyers, § 69 comment d (attorney-client privilege), § 87 comment g (work product immunity) (2001).

[1] Some internal investigations focus on well-defined allegations arising from oral complaints. Investigations of employment discrimination cases are an example. A discovery consultant may not be necessary in these investigations.

Counsel and the e-discovery consultant must examine all possible media for relevant information. Information is not retained just on the organization's server. It may be in text messages, on personal e-mail accounts, on remote devices, on network backup tapes, on security tapes, and in hard copy files. Spencer Fane can help you identify and follow best practices in data collection and retention.

Interviewing Witnesses

Counsel will interview all employees believed to possibly have information relevant to the investigation. For convenience, the employees can be described as within one of the following three categories:

Implicated Employees: The acts or omissions of these employees are believed to expose the company to civil or criminal liability under principles of *respondeat superior*. These employees also have personal exposure for civil or criminal liability. The basis for liability might be the employees' affirmative conduct, the employees' direction that another employee take affirmative conduct or the employees' failure to act notwithstanding knowledge that action should be taken. Implicated employees may be identified as "targets" or "subjects" by prosecutors.

Implementing Employees: The acts or the omissions of these employees may expose the company to civil or criminal liability under *respondeat superior*. These employees, however, are not likely to have personal liability because they merely were acting on the directions of superiors and were not themselves aware that their conduct would cause a violation of law.

Mere Witness Employees: These employees do not expose the company to liability and they have no personal exposure. They may have observed another's conduct or heard about the conduct that is being investigated.

Interviewing the Implicated Employee

The conduct of the implicated employee exposes himself and the company to potential criminal or civil liability. The conduct also presents potential adversity. For example, during the investigation, the organization may conclude that the employee's conduct was improper and not authorized. In the context of a government investigation, the organization may decide to advise prosecutors or others about the employee's conduct if the organization believes the disclosure is in its best interest, knowing it will be contrary to the employee's interest. *See e.g.*, *United States v. Potter*, 463 F.3d 9, 25 (1st Cir. 2006); *United States v. Automated Medical Laboratories, Inc.*, 770 F.2d 399, 407 (4th Cir. 1985) (discussing limitations on *respondeat superior* for imposing criminal liability on employers). In the context of certain civil law investigations, exposing an employee's misconduct may support affirmative defenses available to the organization. *See e.g.*, *Burlington Industries v. Ellerth*, 524 U.S. 742, 765 (1998) (affirmative defense to liability and damages available to employer in cases where employee-supervisor created hostile work environment).

The possibility of adversity between the organization and the implicated employee presents special obligations to the organization's counsel. Before interviewing the implicated employee, counsel is expected to advise the employee of the existing or potential conflict of interest, to state clearly that counsel does not represent the employee and to advise the employee that he may want to seek independent counsel. *See*, ABA Model Rule 1.13(f) and Comment 10 and ABA Model Rule 4.3.

An ABA task force has recommended best practices for counsel conducting interviews of implicated employees in the context of a government investigation. ABA White Collar Crime Committee Working Group, "*Upjohn* Warnings: Recommended Best Practices When Corporate Counsel Interacts with Corporate Employees", ABA (July 17, 2009) ("Best Practices"). The ABA's Best Practices are commonly known as "Upjohn warnings" because they are derived from the U.S. Supreme Court decision, *Upjohn Company v. United States*, 449 U.S. 383 (1981), which established the scope under federal law of the attorney-client privilege for organizations.

The ABA's Best Practices provide (in summary):

> Upjohn warnings should be provided before the interview begins.
>
> Counsel should state:
>
> > that he represents the organization only and not the employee

> that the organization is seeking legal advice regarding the subject being investigated and the counsel is conducting the interview to assist in forming that legal advice
>
> that the organization expects to maintain in confidence the information that is provided during the interview and to assert the attorney-client privilege regarding that information
>
> that the organization may change its position, disclose the information and waive the attorney-client protection that otherwise covers the interview
>
> that the employee's personal obligation is to keep the substance of the interview confidential from all other persons
>
> The employee should be asked to state that he understands the Upjohn warnings and that he is willing to proceed with the interview.

Best Practices p. 3-4.

Counsel must be clear that he represents the organization and not the implicated employee. If counsel's statements are ambiguous, the implicated employee may claim he is the client. For example, counsel's statement that he can represent the company and the witness "as long as no conflict appears" may result in a claim that the lawyer retained to advise the organization actually represented the employee. *In re Grand Jury Subpoena*, 415 F.3d 333, 340 (4th Cir. 2005). This unwanted circumstance can interrupt the company's plans to resolve the matter and might cause counsel to be disqualified from any representation in the investigation. *In re Bevill, Bresler & Schulman Asset Mgmt. Corp*., 805 F.2d 120, 123 (3rd Cir. 1986); *MacKenzie-Childs, LLC v. MacKenzie-Childs*, 262 F.R.D. 241, 250-51 (W.D.N.Y. 2009); Joy and McMunigal, "Corporate Miranda Warnings", Criminal Justice, Vol. 25 No. 2 (2010).

Interviewing the Implementing Employee

Information held by employees in this category may be critical to understanding the allegations. For example, in an environmental investigation, these employees may have received instructions from their manager regarding the release of tainted water; in a financial investigation, these employees may have made accounting entries; or in a healthcare investigation, these employees may have assisted with medical billing.

Implementing employees generally are not adverse to the organization because their conduct was directed by their superiors. The full Upjohn warning generally is not necessary for these employees. In order to ensure the privilege applies, however, the employee should be advised that the interview is confidential and is conducted for the purpose of providing legal advice to the organization.

Interviewing the Mere Witness Employee

Like the implementing employees, regulators and prosecutors want to question employees who observed events or heard discussion on the subject of the investigation. The suggestions provided above regarding implementing employees apply equally to employees in this category.

Establishing Privilege in the Interviews

The Supreme Court's decision in *Upjohn Company v. United States* establishes the basic federal law for privileged communications in the organizational context. Upjohn holds that the organization may claim privilege over communications between its counsel and its employees which are undertaken to secure legal advice for the organization. 449 U.S. at 394. There is no restriction on the rank or position of the employee involved in the communication with the organization's lawyer. *Upjohn* recognizes that the lawyer may need to speak with mid-level and low-level employees in order to understand the pertinent facts and to provide "sound and informed advice" to the corporation. 449 U.S. at 390-91. *Upjohn*, therefore, rejected "a rule that limited privileged communications to those between the lawyer and the corporation's 'control group'". 449 U.S. at 390.

Under *Upjohn*, the attorney-client privilege will protect against disclosure of communications between counsel and a corporate employee or board member ("constituent") if (1) the constituent's information is solicited for the purpose of providing legal advice for the corporation; (2) the constituent's information is needed by counsel to formulate legal advice for the corporation; (3) the information is on matters within the constituent's job duties; (4) the constituent knows the interview is for the purpose of legal advice to the corporation; and (5) the constituent's information is intended by the corporation to be confidential and, at least at the time of the interview, the corporation has no intention of waiving its privilege. *Upjohn*, 449 U.S. at 394-95.

Upjohn also discussed the work product doctrine. It did not break new legal ground, but re-affirmed existing standards regarding the protection against disclosure of an attorney's mental impressions. *Upjohn*, 449 U.S. at 400. An attorney's mental impressions, stated in his documents, are protected against disclosure so long as the impressions are related to litigation the attorney then-reasonably anticipated. Fed.R.Civ.P. 26(b)(3); *See* 8 Wright, Miller and Marcus, Federal Practice and Procedure § 2024 (2010).

State privilege law will control if the focus of the internal investigation is on an alleged violation of state law that is likely to be presented in the state courts. State privilege laws may be based on the *Upjohn* test, the control group concept or some hybrid. In circumstances where lawsuits in state courts are a possibility, counsel should examine state law on establishing the attorney-client privilege and the work product doctrine in the context of internal investigations. Counsel in transnational investigations also must be alert to the possibility that the applicable law will be of a foreign nation which does not recognize the attorney-client privilege. *See*, *Wultz v. Bank of China, Ltd.*, 979 F.Supp.2d 479, 483-84 (S.D.N.Y. 2013).

Separate Counsel for Employees Involved in an Internal Investigation

Often the organization will encourage an employee to retain his own counsel. This opens paths to communication that would be muddled if the organization's counsel attempted to discuss facts and strategy with the unrepresented and potentially adverse employee. The organization's counsel and the employee's separate counsel (with the consent of their client) may share information to the benefit of both.

The communications between counsel may be privileged pursuant to the common interest rule. The application and scope of this rule varies among U.S. and state courts, so the applicable case law must be consulted. *See* Restatement (Third) the Law Governing Lawyers § 76 (2001); 24 Wright and Graham, Federal Practice and Procedure § 5493 (2015).

The organization may have an obligation to advance fees to the implicated employee's separate counsel or advancement of fees may be discretionary. The organization's bylaws and the laws in the state of its incorporation regarding indemnification and advancement will control.

It is common in the context of government investigations, for an organization to advance attorney's fees on behalf of implicated employees whose conduct was at least arguably intended to benefit the organization. If fees are advanced, the implicated employee must give informed consent to payment by the organization of fees to his separate counsel and the organization must not interfere with the commitment by the employee's counsel to his client. ABA Model Rule 1.8(f) Comment 11.

The organization may decide to retain a single lawyer to represent a group of employees who are not implicated in potential wrongdoing but have first-hand knowledge of the events under scrutiny. This is common in government investigations because regulators or prosecutors are very likely to demand the sworn testimony, or at least an interview, of these employees and the employees are not likely to be familiar with this type of legal process. The single lawyer often is referred to as "pool counsel". Employees generally appreciate the guidance that pool counsel provides and the organization's counsel often benefits from factual information that pool counsel is able to share.

Pool counsel has to be alert to unanticipated adversity between any of his clients. Adversity could create a conflict of interest prohibited by ABA Model Rule 1.7(a). In the case of a conflict, the adverse client should be removed from the pool. *Id.* Comment 4.

Understanding "Cooperation"

A critical decision in a government investigation is whether to "cooperate" with the regulator or prosecutor. "Cooperation" is a very broad concept and misunderstandings easily can arise between counsel and the organization regarding the possible benefits of cooperation and the burdens that cooperation may impose. Clear communication on the topic of "cooperation" is necessary.

The organization must understand that cooperation is not the same as compliance. Cooperation typically involves action that is *not required* by law but which is undertaken due to some other motivation. By contrast, compliance is acting as the law *requires* and nothing more. For example, compliance includes producing documents demanded by a grand jury subpoena or allowing regulators to enter company premises in accordance with permit terms.

Cooperation does not result in immunity. The prosecutor's job is to enforce the law. If the organization has criminal or civil liability, it should expect to be sued, notwithstanding full cooperation.

Cooperation generally includes providing information the prosecutor has not asked for. Presentations about the most important facts of the matter under investigation are a common form of cooperation. The most important facts may include incriminating information. Accordingly, cooperation often involves acknowledging responsibility for law violations.

An important development regarding cooperation in federal investigations occurred in September 2015. The United States Department of Justice published a policy memorandum for its prosecutors and civil enforcement lawyers across the country who are investigating corporate misconduct. United States Department of Justice, Memorandum of Deputy Attorney General Yates, "Individual Accountability for Corporate Wrongdoing" (September 9, 2015). The Justice Department lawyers are instructed that their investigations must seriously consider prosecution or a civil enforcement action against employees who were "involved" or "responsible" for the wrongdoing. Legal actions by the Justice Department against employees are expected to become the norm, not the exception. The Justice Department looks to the organizations being investigated to provide the information necessary for legal action against the employees. Under the Yates Memorandum, an organization is not eligible for any cooperation credit unless it makes a thorough investigation of its employees' conduct and also makes a fulsome disclosure of its findings to the Justice Department. The Yates Memorandum may have profound effects. Employees may be unwilling to cooperate in the organization's investigation, reasoning that cooperation will work only to their extreme detriment. Also, organizations may decide that the available cooperation credit is not sufficiently valuable to cause them to jeopardize relationships with high-level executives or others who would be placed in

harm's way. Since the Yates Memorandum was issued in September 2015, its contextual application remains uncertain. Counsel should carefully evaluate how the Yates Memorandum will affect the organization's interest in cooperation.

Full cooperation commonly includes disciplinary actions such as claw-backs of bonus payments, work suspensions or termination. Full cooperation also commonly includes corporate governance changes, operational changes and corporate compliance plans that are designed to prevent reoccurrence of the internal investigation issues.

Cooperation does not include waiver of the organization's privileges. Prosecutors and regulators are interested in *facts* that reveal the law violation but access to counsel's legal advice or mental impressions is not necessary for their work. In the context of federal investigations of crimes by organizations, Department of Justice prosecutors are prohibited from seeking a privilege waiver and they are instructed that their evaluations of an organization's cooperation may not be influenced by its decision to waive or to assert its privilege rights. United States Attorney's Manual (USAM) 9-28.710-720.

Cooperation also does not include declining to pay for an employee's separate counsel. It is inappropriate for a prosecutor to induce an organization to leave its employee without the protection of counsel when the employee's conduct arguably supported the interests of the organization. The Department of Justice recognizes this point as its prosecutors are prohibited from considering advancement of fees when evaluating an organization's cooperation. USAM 9-28.730.[2] DOJ's current position regarding fee advancement reverses its prior position that prosecutors could consider whether the organization advanced fees to "culpable employees and agents" in their charging decision. *U.S. v. Stein*, 541 F.3d 130, 136, 151 (2d Cir. 2008) (*citing* DOJ policy memorandum and holding, under the circumstances, that government violated defendants' Sixth Amendment rights through pressure on the organization to refuse to advance fees).

In almost all cases, cooperation delivers some benefit. If the organization's conduct is unlawful and egregious, the benefit may be limited to small concessions in a plea agreement. If the corporation's conduct was unlawful but minor, cooperation may result in a sanction other than indictment. If the organization is convinced its conduct was lawful, cooperation may be the path to exoneration. The organization must understand the extent of the benefit offered by the prosecutor.

[2] The Justice Department's position that "cooperating" organizations must disclose all information about employees' conduct is not incongruent with the Department's implicit support of the corporation's decision to provide counsel for those employees. The organization is subject to enforcement actions due to its misconduct, not because it provided counsel. Also, counsel for the employee can present mitigating facts that affect enforcement decisions and providing counsel thereby serves the interests of justice.

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