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internal investigations

Current Issues, Practical Guidance

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Roundtable Series 2007

A government subpoena, a civil complaint or the general counsel's suspicion of wrongdoing may all lead a company to undertake an internal investigation. We've invited five noted practitioners to take us through the basics. Joining us are R. Scott Garley, a director at Gibbons PC in New York City; Bruce Goldstein, chairman of Saiber, Schlesinger Satz & Goldstein LLC in Newark; Kevin Hart, a shareholder in Stark & Stark in Lawrenceville, N.J.; Gina Maisto Smith, of counsel to Ballard Spahr Andrews & Ingersoll LLP in Philadelphia; and Peter G. Verniero, a member of Sills Cummis & Gross PC in Newark. This panel was moderated by freelance writer Anne Dorfman and reported by Sharon B. Stoppiello of DepoLink Court Reporting & Litigation Support Services.

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MODERATOR: What are the initial considerations for general counsel who suspect or discover wrongdoing, or who receive a government subpoena or complaint?

SMITH: It's important to assess the nature of the complaint and the potential consequences for your client. Look at the facts, the applicable law, and the current government culture and its attitude toward this type of issue in your industry. If you keep your eye on the forest rather than just overreacting to the tree, you're in a better position to determine what to do next. One of the first things for general counsel to consider is the quality of their responsiveness. Ask, "How do I maintain the perception" — because perception is reality — "of cooperation?" If this is something that can seriously hurt your organization, particularly if it involves or may involve a government investigation, cooperation is key from the beginning. General counsel need to have prophylactic processes in place so that an efficient and appropriate response is made no matter how the problem arises. If general counsel decide to engage outside counsel to investigate, it is critical for outside counsel to articulate at the outset the scope of the investigation as well as its purpose: to give legal advice.

VERNIERO: You do not have unlimited time to react to an allegation or to the filing of a subpoena. You really have to make some critical decisions pretty early on in the process. Hopefully by that time you would already have established a set of independent compliance systems. If you have those in place and they're well implemented, the rest of these decisions become a little bit easier, both to reach and to implement.

HART: You certainly don't want *not* to react to things, and you must also be careful not to *overreact,* because you may take a molehill and turn it into a mountain. Not to say that you want to push something under the rug, but there may be information that requires disclosure once you develop it that may not have been something that necessarily would have had to have been disclosed. It may not necessarily have been relevant.

GOLDSTEIN: One of the most critical things to do if you receive a complaint or a government subpoena is to use a highly technical device created by Alexander Graham Bell and pick up the telephone, call the line prosecutor and find out what it's all about. Communication is critical.

HART: You have to be able to ascertain as soon as possible whether you're in a position where your interests will mirror those of the government, or whether you may actually have to be adverse — because, as we all know, occasionally prosecutors do make mistakes. The easiest way to do that is to hear from the other side, "Here's what we think the problem is."

GARLEY: Your life may not be easier when an actual lawsuit has been filed, but it's a little clearer because at least you have some sense of what the allegations are. That, in turn, guides your investigation — how you set it up, who does what. I do a lot of securities work, and SEC enforcement staff generally will start with an informal inquiry and ask you questions or send you a letter. You get very little detail and you really don't know what they're looking into. This is a good time to call up and say, "Can you tell me more about it? Of course we want to be cooperative, we want to make sure we're addressing whatever needs you have." They may not tell you early on whether your client is a target, but you want to find out why they think your client is involved in whatever it may be.

VERNIERO: Very early on in the process you have to preserve the record. Make sure that no applicable documents are being inadvertently destroyed, no e-mails that might be relevant are being inadvertently deleted. You should have a document management system in place, policies in place, understand what your technology is, how to preserve documents, and so forth.

GOLDSTEIN: If you maintain the integrity of the records, you can insulate your clients from any challenge to the integrity of the document production; if you don't, you may have a serious problem down the road.

HART: If documents are destroyed, that is a nightmare that will not go away.

MODERATOR: The next step is to determine who conducts the investigation.

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-R. Scott Garley

VERNIERO: The decision as to whether to select outside counsel must be made on a case-by-case basis, although clearly there are certain investigations that argue in favor of an outside counsel: any allegation involving a senior officer, a director, general counsel himself or herself — any high-level person. If it's something a little bit more "routine," then you're probably okay to stay in house. Even then there might be something you learn in the course of the process where you say, "We've got to bring in some outside counsel."

MODERATOR: Considerations for both general counsel and outside counsel in managing an investigation?

HART: The advice I always give is very simple. It is, "Assume that everything we do from this point forward will be scrutinized by numerous people. You can't change what has already happened, but you can certainly affect what happens later by what you do once you become aware of a potential problem."

SMITH: Recognize that for general counsel this may be very disruptive for business. If you minimize the disruption, you're going to get a better investigation. Using the forest and trees analogy, you want to understand which tree you're investigating. You're not going to lift every rock and overturn every stone. General counsel don't want to go into an investigation with outside counsel who take a scorched-earth approach. It's imperative to talk about the cost of the investigation and about reporting: who you report to and what the chain of command will be. Also keep your eye on the broader issues, such as tangential lawsuits that may flow out of an investigation — employment lawsuits or shareholder derivative suits, for example. Moreover, it is critical to talk to general counsel up front about the conduct of the investigation. If the investigation is improperly handled, your conduct can eclipse the substance, à la HP.

MODERATOR: HP's outside investigators used false identities to obtain phone records of board members and journalists in an investigation of media leaks — resulting in felony charges against the company's then-chairwoman and four others.

SMITH: If you want to maintain the attorney-client privilege, begin by creating a system to label and manage all work product and privileged communications. Make sure you don't waive the privilege by talking to folks who don't share the privilege. You want to give what are called *Upjohn* warnings, after *Upjohn v. U.S.*: The communications are privileged and for the purpose of legal advice to the company. Make it clear: Who do you represent? The company. Who has the privilege? The company. Who can waive the privilege? The company.

GOLDSTEIN: The reality is that most of us have a relationship with either the general counsel or the associate general counsel of the corporation, who is responsible for having retained us. Yet the law clearly says that if we are serving as outside corporate counsel, our responsibility runs to the corporation, not to the individual who retained us. This is critical to keep in mind. It has obvious implications as to what you tell an executive and the way you tell an executive about who you represent.

HART: By way of example, there is an explosion in prosecutions under the Foreign Corrupt Practices Act, primarily linked to mergers and acquisitions. An acquiring company does its due diligence and a problem is uncovered. They self-report to the government and throw the entire former organization under the bus — and essentially get a safe-harbor pass from the government going forward. I've represented officers from the acquired company and read them a transcript of an interview conducted by "corporate counsel." I was looking for, "Where did they give you your *Miranda* rights?" And they said, " I thought they were my attorneys." And I said, "Well, they just made the case against you." It was clear the attorneys realized that these were the people they were going to turn in to the government.

VERNIERO: How you manage the investigation is going to depend on the scope, the kinds of allegations you're dealing with, whether it is a subpoena or whether it is something purely internal, and so forth. You will have to decide whether it's an issue that needs to be brought to the audit committee's attention, whether it can rest with the general counsel, whether it can rest with the director of litigation. There's no cut-and-dried answer, but

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-Bruce Goldstein

what I am seeing more often than not is that any allegation of any significance is ultimately going to the audit committee, so you may just help yourself by going to that place sooner rather than later.

GOLDSTEIN: Let's assume that you represent a client that is doing business in another country. The vice president says, "Bruce, how do you think we got these contracts? We didn't pay cash. Only an idiot would pay cash. We retained the law firm of XYZ and they took care of everything." Is there any obligation at any point to say, "You know, you probably ought to get a lawyer to represent you," or do you wait until the executive incriminates himself with highly relevant information that may be invaluable to the corporation in enabling it to demonstrate cooperation with the government, and then say, "Now would be a good time to get a lawyer because you may have a serious problem"?

VERNIERO: I think that's become one of the most difficult questions that outside counsel has to grapple with. At some level you're merely saying to a CEO or to the person you're dealing with inside the company that, perhaps, this is an appropriate time to consult their own lawyer. But are you, in effect, giving legal advice with that single sentence? Is that appropriate? If yes, when should you do that? Should you ever do it? Difficult questions.

MODERATOR: In December 2006 the DOJ issued the McNulty Memo, which added restrictions to guidelines for federal prosecutors seeking privileged information from companies. It created approval requirements and two categories of information: Category I is "purely factual"; Category II is "attorney-client communications or non-factual attorney work product," which "should only be sought in rare circumstances." Previous guidelines, set forth in the Thompson Memo, had been widely criticized for making waiver of the attorney-client privilege a criterion of cooperation with the government.

VERNIERO: When I went to law school, the practice was that when an attorney prepared a document, he or she infused that document with attorney impressions and observations — not just the facts — because that was the best way to keep something privileged. Now, under the McNulty Memo, in this climate where the government on many occasions will ask that the attorney-client privilege be waived, you have to be very careful about putting observations and impressions in documents. There is a practice developing where, rather than create one document, an attorney will create two: one that fairly exclusively recites the facts, which if released to the government would be no more than a fact report; and one that has conclusions of law, impressions, and so forth.

HART: This would be Category I or Category II under McNulty.

GARLEY: I've done investigations where I've used a court reporter. The witnesses are not under oath and we're not taking a deposition, but we're making a verbatim record of what people say. You may at some point say to the prosecutor or regulator, "Look, I'll give you our factual material." That might be a way to appease the prosecutor, if you feel it's appropriate under the circumstances, without giving up your mental impressions or other privileged materials.

GOLDSTEIN: What you're suggesting is really a great idea, because you can clothe yourself in the garment of the McNulty doctrine, which really makes that specific breakdown in terms of what can be produced and what can't be produced. It makes it far more difficult to get that second category of material.

GARLEY: And it gives you a better, more defensible argument when they ask for your privileged materials.

GOLDSTEIN: Yes.

VERNIERO: One other point about cooperation. Corporations have rights, too. We sometimes forget that because we think of institutions as nameless and faceless. Despite that, as a practical matter, it is not necessarily an even playing field when you are up against the government. The government has subpoena power, it has the power to compel, it has the power and authority to indict — and to indict a corporation is essentially capital punish-

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-Kevin Hart

ment. So whether or not to cooperate is a very difficult decision. If you don't want to cooperate, that's your right. But if you decide to cooperate, be prepared to really cooperate. Most prosecutors know when they're being fooled.

MODERATOR: How is the McNulty Memo viewed after almost a year of application?

SMITH: It's viewed as the same rules, just with more bureaucratic hoops. The government can still ask a company to waive the attorney-client privilege. I do think the McNulty Memo is an attempt to make government requests for waivers of privilege more meaningful and informed, but the reality is that the rules still allow waiver requests.

HART: The real problem here is that after the Thompson Memo, we started to have a situation where prosecutors, instead of doing their own work, essentially started to say, "We'd like you to do the work for us and build the case for us." There's an attempt to have defendants essentially convict themselves, when they're really attempting to act in a responsible manner in looking internally at what their problems might be. There is something that seems fundamentally unfair about that.

MODERATOR: What are some of the concerns for attorneys representing individuals as opposed to corporations?

GARLEY: Sometimes there is a potential conflict with what the corporate counsel may be doing in representing the corporation. Generally speaking, you might want to solve that with a joint defense arrangement, but we know the lack of regard the government has for joint defense arrangements. As attorney for the individual — respecting my obligations to my client and my attorney-client privileged communications with my client — I would also try to maintain regular communication with corporate counsel, so that we can possibly finesse the situation a bit without looking like one is dominating the other. But the bottom line is that you still have to represent the interests of your client.

GOLDSTEIN: That's the biggest challenge. One has to recognize that the corporate counsel may just say to an employee, "I am representing the corporation and I am directing you to answer all questions posed by the corporate investigator." If you are representing the employee, you have an enormous dilemma to help your client resolve. On the one hand, you need to protect his constitutional rights if his answers could be incriminating, but on the other hand, you have to recognize that if he invokes his Fifth Amendment right, he may be saying good-bye to his employment, stock options and other corporate benefits. If you are representing the individual employee, it is essential that you try to maintain an open line of communication with corporate counsel.

GARLEY: If a director or officer, and maybe even the general counsel, is possibly implicated, the corporate counsel may then have to say to the general counsel, "Look, you have to get truly independent counsel, whether for the board, the audit committee or the special litigation committee." Analogously, a lot of times a lawyer representing an individual officer is a friend or a recommendation of the general counsel or the corporate counsel, or even the audit counsel. When you say, "I'm going to get you separate counsel, and I'm going to get you my friend Joe," that may not be good enough. You may have to let the officer choose counsel.

HART: Even where you might refer someone to an attorney who you believe is competent and will presumably follow all the ethical considerations, the appearance may still be that this person was sent to someone.

GARLEY: That's generally one of the first questions I get asked. The SEC staff or other regulator comes in and says, "Well, what relationship do you have to the outside law firm?" In a lot of cases I'm selected because I used to work at that law firm or they know me from other matters. They trust me, they know I'm a good lawyer. Hopefully the government is not thinking I'm going to be a lackey, but a lot of times that is the inference they will draw, or at least they will ask that question.

GOLDSTEIN: On the other hand, if I'm representing a corporation, I don't want a hostile lawyer or an ignorant lawyer representing that officer. I want someone I can talk to. He

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-Gina M. Smith

may say, "Bruce, I can't talk to you." That's okay. But I want to make sure that I can try to put together a network of lawyers who are comfortable with each other, know what the roles are, know what the law is and have experience representing witnesses in grand jury investigations.

VERNIERO: If a prosecutor has a choice between dealing with an experienced lawyer with some prior relationship with the corporation versus someone who's unknown but has no such connection, I think most prosecutors generally will want to work with the experienced lawyer who is known to be credible.

MODERATOR: How do you maintain the integrity of an investigation?

SMITH: You want to avoid the appearance that the tail is wagging the dog. If you are doing the investigation on behalf of an audit committee, you need to maintain independence. You don't want to allow the CEO or general counsel to direct the investigation.

GARLEY: Trying to maintain the integrity of the process is the biggest problem that I run into in these types of investigations because you get this all the time: The CEO says, "Well, what's going on?" "I can't tell you." In what I call the "scope and task letter" I say, "Here's how it's going to be done. Here's why we have to preserve the integrity. We can't deviate from this protocol." They need to understand that up front. Then be consistent with and faithful to that process, regardless of the standing of the person you're interviewing. I've had CEOs say to me, "I don't have time to be questioned, but I can talk to you in the car on the way to the airport." That doesn't really help me. Also, you can't really stick to an interview script too much because then people will tell the next person, "Here's what you're going to be asked," and now they've prepared their answers beforehand. On the other hand, you have to be consistent in some of the questions and some of the issues you raise because eventually you're going to have to compare apples to apples.

HART: If there are employees you need to interview, don't do it on site. Avoid the situation where you're sitting in a conference room and everyone in the hall knows who's been in there and who's next, and rumors start flying. The general counsel has to understand that it is probably in the best interests of both the general counsel and the entity that there is a truly independent, objective determination as to the facts, to avoid any suggestion that this was directed or there was an intended result.

GARLEY: That's why I spell out the protocol in in my scope and task letter. You give them notice, you get agreement and you get buy-in on the process, so nobody can say, "Well, I didn't know that was going to happen."

GOLDSTEIN: That's a fabulous idea, to put that into an agreement so that it's spelled out up front and you get their buy-in. And if you don't get it, then you don't have a relationship and it's time to move on.

SMITH: It's a very tricky spot that you're in as outside counsel because at times you are being hired by the person you have the relationship with, either the general counsel or the CEO. What I tell them is, "I understand the issues, but I need your cooperation to protect the company."

MODERATOR: What about compliance programs?

SMITH: You need a compliance program that has teeth, that acknowledges the problems that occur in your industry, which you must be — are charged to be — aware of.

HART: That's what the government will look at. Not only, "Did you have a compliance program in place?" but "Was it actually enforced? Is it just a handbook that no one ever looks at?"

GOLDSTEIN: A strong company program is also important to counterbalance the pressure imposed on senior executives to meet corporate-imposed targets in order to enhance the value of corporate stock. That dichotomy has been at the center of every major corporate scandal that we have witnessed in recent years.

GARLEY: Compliance programs, internal policies and procedures, and the internal controls that Sarbanes-Oxley requires not only tell the employees what's expected

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-Peter G. Verniero

of them, they also give the corporation an affirmative defense in the event that an issue arises regarding the actions of officers or directors.

MODERATOR: What kind of report do you provide once you've concluded an investigation?

VERNIERO: It depends on the scope, on what the expectations are from the client's perspective at the outset, on whether you're doing an internal investigation that's prompted by a government subpoena where you think the government is going to expect some written document, or whether general counsel just wants to do a serious double check that there are no problems because other companies in the same industry are having problems.

SMITH: Some of the pros of having a report are that if it's a very serious or detail-oriented issue, or a very extensive issue, it's good to have something in writing for whoever is reviewing it to think about and respond to. It allows management to show that they carried out their fiduciary duty to the company rather than handling a very serious issue with an oral report. Particularly if it's a public company, you don't want the outside perception that this was an inside job. The cons are that a report can be subpoenaed and it can be used against you in a civil or criminal proceeding. And cost: it is no small cost to integrate the entire investigation into a written document. And now you want to factor in what the McNulty Memo has allowed prosecutors to reach for.

HART: Traditionally the detailed report is not only going to contain facts, but also observations and conclusions, which makes it privileged. However, that may be putting you right into a situation where this may be sought by the government. You may be in a position where you may be turning over information that you may not have to turn over, or certainly may not wish to turn over at that time.

GOLDSTEIN: If you do a detailed report, you must recognize that it may some day be disclosed to third parties and may be damaging to the company. On the other hand, if you do not do a detailed and substantive report, the very thing that you were trying to accomplish by writing the report may not be achieved. What I would like to raise is this question: You write a draft report to the general counsel and it is very critical of the company. Do you give it to general counsel and ask for her thoughts? What do you do if you don't agree with some of her editorial revisions? The answer is clear: you have to maintain your own integrity while maintaining an open line of communication with general counsel.

SMITH: It is always in the best interests of the company to maintain the independence of the investigation and the findings. A review by the client is in order, but substantive edits (provided there is no new information) of legal conclusions are not.

VERNIERO: I think that's the line we need to draw. We have to have a little humility here. Despite all the best practices, note taking, thoughtful questions, and so forth, we could be wrong on the facts. So I don't think you're compromised by going to the GC and saying, "Look, here's what I'm finding as the facts. Tell me, have I made the wrong assumptions? Educate me." Not "tell me what to say" but "educate me on the facts." Once outside counsel has been educated on the facts, then the conclusions or recommendations should be his or hers alone.

HART: If the general counsel has brought you in, to some degree I think you owe it to them to give them a heads-up, as opposed to their being blindsided. If they say, "Well, you've got this completely wrong," then I would always say, "Tell me why. We all want to be correct." In fairness, you need to know that you have looked at all of the relevant information and facts before you come to a conclusion.

SMITH: I favor a detailed outline that draws no legal conclusions, which you present with the supporting documentation that the company has provided to you, and you interpret in a meeting for the audit committee. That way, in light of McNulty, in light of the culture of waiver, you have maximized the benefit for your client and minimized the risk.

GARLEY: I will always write a report, for all the reasons we've talked about. The context and style may vary depending on the circumstances. Typically it's to the audit committee or special litigation committee. I will give an oral presentation of my findings before I write it, so they know what's coming. When I write the report it is also more in the form of an executive summary. It's very matter-of-fact, not a lot of detail in terms of both the factual recitation and the analysis. There's plenty of underlying detail from my interview records, the documents and everything else. Then I leave it to the regulators or the class-action lawyers or whoever may be coming down the pike to have to draw it out. Good luck trying to get it from me or my team. The other problem I get, however, is when the client gets a favorable report from me, and now they want to gild the lily and build it up so that they can use it as a defense to the class action and to the regulators. Or even worse, they want to use it in their advertisements on T.V. And then they'll say, "Well, I want to give that to my brother-in-law." Wait a second. The confidentiality works whether the report is negative or positive.

VERNIERO: While following the various rules and practices that we've been discussing here, there's still room for common sense. Don't abandon that. ■

panelist bios

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Bruce Goldstein is chairman of the firm and concentrates his practice on complex business litigation, professional liability and the defense of white collar crime. Considered by his peers to be a "lawyer's lawyer," he is frequently consulted by his colleagues when they need representation. A fellow of the American Bar Foundation and the American College of Trial Lawyers, Bruce Goldstein is a recipient of the Trial Attorneys of New Jersey Award, the William J. Brennan Award presented by the Trial Advocacy Institute of the University of Virginia School of Law, and the Judge Learned Hand Award for humanitarianism presented by the American Jewish Committee.

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Gina Maisto Smith is of counsel in the Litigation Department at Ballard Spahr. She focuses her practice on developing corporate compliance and governance programs for clients of all sizes and across all industry segments. Ms. Smith conducts sensitive internal investigations and defends corporations and individuals facing criminal investigation and prosecution by federal, state and regulatory authorities. Prior to joining Ballard Spahr she served for 18 years as an assistant district attorney in Philadelphia, where she prosecuted high-profile homicide, rape and complex criminal cases. Ms. Smith received her B.A. in 1983 from Saint Joseph's University and her J.D. in 1987 from Temple University Beasley School of Law.

Ballard Spahr Andrews & Ingersoll LLP is an Am Law 100 firm with more than 500 lawyers in 11 offices in the Mid-Atlantic corridor and the Western United States. Ballard Spahr clients include Fortune 500 corporations, hospitals, universities, financial institutions, managed care organizations, defense contractors, utilities and many other businesses. The firm also represents corporate directors, officers and managers as well as other professionals including doctors, lawyers, public officials and accountants. Ballard Spahr combines a broad scope of practice with strong local-market knowledge to represent companies, individuals and other entities. For more information, please visit *www.ballardspahr.com*.

Peter G. Verniero is co-chair of Sills Cummis & Gross' Corporate Internal Investigations and Business Crimes Practice and chair of the Appellate Practice. He joined the firm in September 2004 after a decade of service in senior positions within the executive and judicial branches of state government, including chief counsel to New Jersey Governor Christine Todd Whitman, the governor's chief of staff, attorney general of New Jersey, and associate justice of the Supreme Court of New Jersey. Mr. Verniero is the recipient of numerous honors and awards. His essays on legal and public policy issues are widely published.

Sills Cummis & Gross PC is one of the largest law firms in New Jersey. With both a national and international presence, the firm's clients range from Fortune 500 to emerging-growth companies in industries such as life sciences and health care, banking and finance, commercial and retail real estate, manufacturing, technology and telecommunications. Given the firm's industry knowledge, business savvy and commitment to client service, companies rely on it for representation in corporate transactions, corporate governance, complex litigation, real estate and regulatory matters. With over 175 attorneys, the firm has offices in Newark and Princeton, New Jersey, and New York City. For more information, please visit *www.sillscummis.com*.

Kevin Hart has spent 30 years litigating civil and criminal cases in both federal and state courts on behalf of corporations and their boards. He frequently handles matters ranging from accusations of securities fraud to shareholder disputes, criminal fraud and embezzlements. He also conducts internal investigations related to almost every significant area of white collar crime, including securities, health care fraud, RICO, public corruption and environmental crimes. He is a former deputy attorney general with the State of New Jersey, focusing on white collar criminal matters, and businesses and their boards benefit from Mr. Hart's knowledge and experience in both the boardroom and the courtroom.

As corporations come under increasing levels of scrutiny, the importance of corporate governance and regulatory compliance is at the forefront of director and officer responsibility. **Stark & Stark**'s Corporate Investigation and White Collar Group offers a range of services including internal investigations, defending corporations and individuals in grand jury investigations and trials, civil litigation and administrative enforcement actions. We also assist in managing responses to search warrants, subpoenas, document production, complex state and federal prosecutions, and seizure cases. The group, comprised of seasoned litigators and former DAGs, formulate and implement proactive strategies to minimize the potential for future investigations. For more information, please visit *www.stark-stark.com*.

R. Scott Garley is a member of the firm's Business and Commercial Litigation Department, chair of its Securities Litigation Team and co-chair of its Private Equity and Hedge Fund Group. Mr. Garley also is a member of the firm's Sarbanes-Oxley Act Compliance Committee. He focuses his practice on litigation, arbitration, investigations and counseling in connection with securities transactions and regulatory matters, directors' and officers' liability and corporate governance matters, executive compensation and employment matters, business tort claims and complex commercial disputes. He is a member of the Panel of Arbitrators of the Financial Industry Regulatory Authority and the United States District Court for the Eastern District of New York. He is AV® Peer Review Rated by Martindale-Hubbell and listed as a leading attorney in the Securities Litigation practice area by *Super Lawyers* magazine.

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