

# The Metropolitan Corporate Counsel<sup>®</sup>

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Volume 12, No. 8

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August 2004

## Corporate Internal Investigations In The 21st Century: Proceed With Caution

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The internal investigation has become a well-accepted feature of the corporate legal landscape over the last 25 years. Building upon the Supreme Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), courts accorded more and more protection to the corporation's lawyers in conducting internal investigations into possible wrongdoing by employees and agents. Corporate counsel, faced with allegations of wrongdoing within the corporation, correctly believed that the best way to represent the corporation was to get to the bottom of the allegations in a manner that could, under existing interpretations of the rules of attorney-client privilege and attorney work-product doctrine, be kept as confidential as the corporation deemed appropriate.

By the late 1990's, the internal investigation had become a standard item in corporate counsel's toolbox, and it was not uncommon for a large corporation to be involved in two or three investigations at the same time. In fact, recognition of the frequency of such investigations had led some companies to supplement their in-house legal staff with former federal and

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state prosecutors, regulators, and others for the specific purpose of conducting such investigations when the need arose.

Recently, the federal government has demonstrated its recognition of the ascendancy of the internal investigation. Perhaps predictably, this recognition imposes significant burdens, and risks, upon corporations. Corporate counsel contemplating an internal investigation into allegations of potentially criminal conduct on the part of employees must be aware of the full range of government initiatives in this area, as well as the interplay between and among such initiatives, when conducting an investigation.

### **Reasons For Conducting Investigations: Sarbanes-Oxley**

When corporate counsel is made aware of an allegation of criminal wrongdoing by corporate employees, the decision to conduct a private investigation into the allegations is often easy. Until

recently, the calculus included counsel's desire to get to the bottom of the allegations in order to prepare a defense to civil or criminal charges, take remedial measures, and, if necessary, make appropriate disclosures. For many years, there was little risk to conducting an investigation as the courts afforded such investigations the protection of the attorney-client privilege and, often, work-product protection from discovery.

By the 1990's, some courts refused to protect the results of internal investigations under certain circumstances, *see, e.g., In re Kidder Peabody Securities Litigation*, 168 F.R.D. 459 (S.D.N.Y. 1996), but those cases were the exception not the rule, and counsel could still take steps to protect the results of investigations from compelled disclosure. *See In re Health Management Inc. Securities Litigation*, 1999 WL 33594423 (E.D.N.Y. April 15, 1999). Counsel not satisfied with the

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level of protection likely to be afforded an investigation could forego a formal investigation and address allegations of wrongdoing in other ways.

Today, however, counsel's hands may be tied when considering whether to conduct a formal investigation. Rules implemented by the Securities and Exchange Commission effective in 2003, as mandated by the Sarbanes-Oxley Act of 2002, strongly encourage corporate counsel to conduct formal, documented investigations when allegations of wrongdoing are made. It is at least arguable that the SEC's rules require counsel to conduct an investigation or direct outside counsel to do so under certain circumstances. *See* 17 C.F.R. Section 205.2(k). The consequences of failing adequately to investigate allegations of wrongdoing can be serious, both for the individual corporate counsel and for the corporation.

Today, therefore, corporate counsel may feel compelled by government regulation to conduct formal investigations where none was required or even necessarily appropriate in the past. Under such circumstances, it is essential that counsel fully understand the consequences of conducting an investigation before commencing one. Certain policies and practices of the United States Department of Justice, which have been adopted by many state and federal regulators and law enforcement authorities, create new areas of risk where none existed before.

#### **United States Department Of Justice Policy: The Thompson Memorandum**

What makes the initiation of a formal internal investigation especially serious in today's environment is the danger that the corporation will be compelled to disclose the results of the investigation when it is complete. This risk is particularly high in cases involving conduct that appears to have violated criminal laws, where, paradoxically, the need for confidentiality is arguably greatest. This is so because of recent developments in the policies and practices of law enforcement authorities (most notably the United States Department of Justice) that effectively require corporations to surrender to the government the results of internal investigations in order to attempt to avoid criminal charges.

The United States Department of Justice has for many years had policies in place that describe the factors prosecutors should consider when deciding whether to charge a corporation with criminal vio-

lations. *See, e.g.* Federal Prosecution of Corporations, Department of Justice Criminal Resources Manual § 162 (2001); United States Attorneys' Manual ("U.S.A.M.") § 9-27-220, *et seq.* One of these factors has been the extent to which a corporation facing possible charges cooperated with authorities in the course of the government's investigation. *See* U.S.A.M. § 9-27-230(B)(6) (2000 Supp.). Typical indicia of corporate cooperation included the corporation's willingness to give the government access to officers, directors, employees, and company documents, to withdraw from joint defense agreements, and to make immediate restitution for any losses incurred by others as a result of any allegedly criminal conduct.

In the late 1990's, some prosecutors began to demand more of a corporation to satisfy the cooperation requirement for non-prosecution. Aggressive prosecutors began to demand that the corporation waive attorney-client privilege with respect to some matters, including the results of internal investigations. This anecdotal practice became more and more widespread until, in January 2003, Deputy Attorney General Larry Thompson of the Department of Justice issued a memorandum setting forth a "set of principles to guide Department prosecutors as they make the decision whether to seek charges against a business organization." Memorandum from Deputy Attorney General Larry Thompson to Heads of Department Components and United States Attorneys, January 20, 2003 ("Thompson Memo"), at page 1. Included in the set of principles is a detailed description of the kind of cooperation demanded of corporations wishing to avoid criminal charges. Among the factors considered important in the Thompson Memo are the corporation's willingness to identify culprits and waive attorney-client privilege and work-product immunity. (While a complete analysis of the Thompson Memo is beyond the scope of this article, counsel should be aware that it contains a list of factors that indicate a potential lack of cooperation, including advancing attorney's fees to employees under investigation and "overly broad assertions of corporate representation of employees or former employees," Thompson Memo at page 6.)

The Thompson Memo specifically identifies the corporation's willingness to turn over the results of an internal investigation as one indicium of cooperation. *Id.* at page 5. Regardless of whether the

Thompson Memo is prescriptive or merely descriptive, it is clear that federal prosecutors now routinely demand the results of any internal investigation conducted by the company, and make it clear that failure to turn over such materials will be viewed as non-cooperation. Other law enforcement authorities – such as federal regulators and state prosecutors – have also adopted this practice. It is now the rule, and not the exception, that a corporation faced with potential criminal charges will be asked to surrender the results of any internal investigation conducted.

As many commentators have pointed out, once a corporation surrenders its work-product – such as the results of an internal investigation – to the government, it is likely that civil litigants will argue that the materials disclosed have lost their confidentiality and must be produced. This can have serious adverse consequences, not only with respect to the subject of the investigation, but in virtually any litigation in which the corporation may find itself down the road. This risk exists no matter what steps are taken to preserve confidentiality. Moreover, the argument that the disclosure was compelled – and not voluntary – is unlikely to change the ultimate result. *See, e.g., In re Steinhardt Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993).

#### **Conclusion**

Corporate counsel who learn of allegations of criminal wrongdoing within the corporation face difficult problems. On the one hand, counsel may be required to order a formal investigation of the allegations, with attendant report and recommendations. On the other, counsel may be required to disclose all of the work-product relating to the investigation if the events at issue come under prosecutorial or regulatory scrutiny. In such circumstances, counsel must assume that the results of the investigation will become public, and must therefore be certain that all those with authority for the direction of the investigation are aware that it is likely to become public. This means that, among other things, care should be taken to plan the investigation carefully, that written communications should be drafted understanding the consequences in other contexts, and that the investigation should be focused specifically and with precision on the issue under review. Collateral damage from the investigation can be minimized if counsel tailors the investigation to the need.