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The First 72 Hours of a Government Investigation: A Guide to Identifying Issues and Avoiding Mistakes

Sheila Finnegan



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2007 UPDATE

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PREFACE

In February 2006, we were pleased to publish the inaugural edition of Sheila Finnegan's "The First 72 Hours of a Government Investigation." This *Briefly* has proven to be a valuable resource and guide for corporate counsel trying to navigate the myriad and complex issues triggered by a government investigation.

The initial hours and days after learning of an investigation often pose the greatest challenge and present the greatest risk, as companies grapple with these issues under tight time constraints and with minimal information. They must tread carefully, continually assessing both the near-term and long-term consequences of each decision as it relates not only to the government's investigation but also to potential collateral civil litigation.

Ms. Finnegan has updated the *Briefly* to reflect new case law, the recently announced changes in the Department of Justice's Charging Guidelines in Corporate Fraud Prosecutions ("The McNulty Memo"), and the implications of newly revised Rule of Civil Procedure 37(f) on e-discovery. The author presents a revised checklist of issues that general counsel and others inside a corporation should consider at the onset of a government investigation. Ms. Finnegan highlights the competing concerns that must be recognized and weighed in order to make well-informed decisions and avoid costly mistakes.

Like all other publications of the National Legal Center, this monograph is presented to encourage greater understanding of legal issues, legal procedures, and the law. It is intended to enlighten its readers through the thought, experience, and knowledge of others. The views expressed in this monograph are those of the author and do not necessarily reflect the positions of the advisers, officers, or directors of the National Legal Center.

This publication is presented purely as an educational public service. This monograph is for general information and should not be used as a substitute for legal consultation on a specific matter.

Richard A. Hauser
President, National Legal Center

INTRODUCTION

When a company learns that it is the focus of a government investigation¹—whether from investigators attempting home interviews of employees, the service of a subpoena or search warrant, or some other means—the general counsel must be ready to respond immediately and navigate a minefield of complex issues. Because critical decisions must be made quickly and often without the benefit of complete information, the challenges and risks are substantial.

Identifying the issues that need to be considered in the crucial first hours and days is itself a daunting task. These issues include preservation of documents, particularly electronic data; disclosure requirements; assessment of the accuracy of imminent public statements and/or SEC filings; whether restrictions should be imposed on trading in the company's securities; whether to retain outside counsel and who to retain; internal investigation issues (e.g., should officers/employees have separate counsel and who should bear these costs?); preparing for potential press inquiries and collateral civil litigation; assessing the need for remedial measures; and reviewing the plans in place if the government executes a search warrant.

Missteps in the critical early hours and days after learning of a government investigation—whether from the failure to act or the failure to consider all the ramifications of a chosen action—can have costly and far-reaching consequences for the company. For this reason, we have attempted with this monograph to create a concise guide or checklist of issues that frequently arise during this crucial period, and to highlight some of the key considerations for each.

Because the analysis and best course of action necessarily will depend upon the particular facts confronting the company, and because the law surrounding these issues continues to develop, this monograph is not intended to give any specific advice or definitive answers or suggestions. One size

¹ We use the term "government investigations" loosely to refer to investigations conducted not only by traditional state and federal law enforcement agencies such as the Department of Justice and state Attorneys General, but also the Securities and Exchange Commission and self-regulating organizations ("SROs") such as the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE").

does not fit all. Nor does the monograph provide a comprehensive analysis of each of the many issues that are flagged, as each issue in itself would require a detailed discussion. Rather, this monograph is intended to be a reference to assist in-house counsel in quickly identifying potential issues to consider and discuss, both internally and with specialists in internal investigations and related areas, before making any definitive decisions that could adversely affect the company. The first part of the monograph describes these issues. The second part focuses on actions to consider in the event that the government executes a search warrant on company premises.

PART I:

KEY ISSUES TO CONSIDER IN THE CRUCIAL EARLY HOURS AND DAYS AFTER LEARNING OF A GOVERNMENT INVESTIGATION

A. Protocol for Contacting Counsel and Others

The company may first learn of a government investigation outside normal business hours. For example, government agents may appear unannounced at the homes of employees on a Saturday morning, seeking to interview them. Alternatively, agents may descend on a company's branch office on a Friday evening with a search warrant. Because counsel needs to learn of these events and respond as quickly as possible, it is important to have a protocol in place to ensure that counsel is contacted immediately regardless of the time or day. Counsel, in turn, must be able to quickly reach outside counsel, media relations experts, and others for possible assistance, so he or she should have ready access to home and cell phone numbers for such persons. For obvious reasons, this protocol should be in place before the company learns of an investigation.

B. Preserving Documents and Suspending Routine Destruction Practices

One of the first steps that counsel must take after learning that the company and/or its officers and employees are under investigation is to suspend automatic document destruction practices to avoid the inadvertent destruction of pertinent documents and electronic data. Counsel should also issue a written directive to all who may possess such documents to preserve them.

Like many of the myriad issues that will confront counsel, the issue of document and information preservation is far more complex than sending out directives to preserve documents. For example, e-mails and other electronic data may be destroyed despite the issuance of such a directive because

(among other reasons): (1) the data is in shared space on the computer server so no employee views the data as his/her own and takes responsibility for preserving it; (2) the computer system has automatic delete features (e.g., e-mails that remain in an in-box after a certain number of days are automatically deleted); (3) employees simply disregard the preservation directive; and (4) the company regularly recycles backup tapes.

Destruction of relevant documents, even if inadvertent, can have dire ramifications for the company. The government undoubtedly will investigate the circumstances of any destruction to determine whether criminal obstruction charges are warranted.² Even if the government determines that there is insufficient evidence to bring obstruction charges, the government may well view the company with suspicion in future dealings and question the sincerity of the company's stated desire to cooperate. The government may also be less likely to agree, at least preliminarily, to limit the scope of any subpoena and to grant additional time to gather documents. The government might even consider seeking a search warrant.

For these reasons, counsel should work with the IT department to acquire an understanding of the company's computer systems and the steps necessary to quickly preserve electronic documents. This is also important because the government sometimes will ask to interview IT employees on these topics shortly after a subpoena is served to ensure that the company is doing everything possible to preserve electronic data that may be responsive to the subpoena.³

² One of the criminal obstruction statutes that the government may consider (among others) is section 802 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1519), which provides:

[w]hoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or in contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

To date, this language, although referenced, has not been interpreted by a court. It appears, however, to eliminate the nexus between the destruction of documents and an official proceeding. The statute also does not appear to require a willful or corrupt state of mind, although it is unclear, after the Supreme Court's decision in *Arthur Andersen v. United States*, 544 U.S. 696 (2005), whether one can be convicted of criminal obstruction without such intent.

³ A cover letter accompanying a recent subpoena issued by the Antitrust Division of the Department of Justice requested that the company arrange for an interview of IT employees who could respond to the following questions:

Company's Computer Hardware and Systems

- types of computers (e.g., mainframe, workstations, laptops);
- types and versions of all operating systems (e.g., Windows, Linux, UNIX), including dates of major changes or operating grades;
- number/types of servers (e.g., Exchange servers) and the location of servers (e.g., physical locations and addresses);
- employees' use of laptops to conduct business, and how the laptops are connected to the network servers (e.g., remote access programs, synchronization procedures);
- employees' use of their home computers to conduct business, and how those computers are connected to the company's network (e.g., remote access, Web access);
- employees' use of handheld devices (e.g., BlackBerrys, Treo smartphones, Palm Pilots) to conduct business;
- all data storage locations outside of the United States containing data created by the company in the United States.

Company's Application Software Programs

- e-mail programs used by the Company (e.g., Microsoft Outlook); when the current e-mail system was implemented; whether any other e-mail systems were in use during the subpoena period; if the company has any policy on where employees are to store their e-mails (e.g., on a network server or their local drives); whether employees can access their e-mails remotely from outside the office; whether employees' e-mail folders are automatically archived on the network server; whether any "janitorial" programs are run to periodically purge old e-mails; if any other policy limits are enforced on employees' e-mail accounts; and which company personnel are responsible for administering the company's e-mail system;
- electronic calendaring software programs;
- word processing and spreadsheet software programs;
- voice-mail programs, and the period for which voice-mail messages are retained by the company;
- internal company instant messaging ("IM") programs, and the period for which IM text messages are retained by the company;
- any financial and accounting programs;
- document management programs;
- customized software programs that create or maintain any data responsive to the subpoena.

Company's Backup Procedures

- the types of backups that the company performs (e.g., full backups, incremental backups);
- the types of data backed up by the company (e.g., e-mails, word processing documents);
- the company's backup schedule (e.g., each business day, weekly, and monthly);
- what backup media, such as tapes, are recycled for reuse (and thus overwritten);
- what backup media containing potentially responsive data were in existence at the time the subpoena was issued to the company;
- whether the backup media are individually labeled by type of data stored on the tape or by employees whose data is stored on the tape;
- whether backup media are indexed and/or logged by backup software;
- the type of media on which the backup data is stored;
- whether the company has restored backup tapes within the last two years for any purpose, including for other litigation or to retrieve data inadvertently deleted from the company's computer systems;

The following are a few steps (of many) to consider in the early stages of an investigation to avoid inadvertent destruction of documents and electronic data:

1. *Halt the Routine Disposal of Documents and Electronic Data*

It is no easy task to figure out all the places where responsive electronic data exists and what must be done to preserve it. Counsel will need to discuss with IT employees and others what information is stored on PCs and in networked e-mail accounts, as well as in any storage under the employees' individual control (such as PDAs, laptops, ZIP drives, voice mail). Recent government subpoenas have explicitly identified what should be preserved, including electronic calendars, instant messaging logs, voice mails, and all removable electronic media used for data storage. If there is an automatic deletion feature on e-mail, it may be possible to turn the feature off for designated employees. Another option is to make a mirror image of the accounts of employees who are likely to have responsive documents. Nonlawyers in the firm must be made to understand the importance of being thorough in identifying and preserving all relevant documents and data. Help from outside experts should be considered.

2. *Preservation Memo*

In any preservation memo that is issued, counsel should try to identify as broadly as possible all documents to be retained and all persons who may

- the company's use of remote, online backup service to maintain and store the tapes;
- the location of any and all backup media, whether on- or off-site;
- the maintenance and location of disaster recovery tapes.

Company's Archival Data

- what types of data the company archives;
- how archived media are labeled, indexed, and/or logged;
- the type of media on which the archived data is stored;
- whether the company has restored archived tapes within the last two years, for any purpose;
- the location of the archived media.

Company's Databases

- databases used by your company to manage data relating to the subject of this investigation, including any databases containing the identity of customers, or historical sales or pricing data.

The government also requested that the company produce, prior to the interview of the IT employees, documents describing the document retention policy and the computer systems, as well as organizational charts.

possess such documents, including third parties such as independent contractors who may possess pertinent documents or data over which the company has control or a legal right. Counsel should also consider sending the preservation memo to employees in overseas offices if they possess materials that may fall within the scope of the government's investigation. Consider having recipients of the memo acknowledge their receipt and understanding of the memo. Sometimes this can be done by a return e-mail. Reissue the memo periodically, and continually reevaluate the scope of the memo for any needed alterations and expansion as more information about the investigation becomes available. Consider whether to audit employees' compliance with the memo. Keep in mind that the preservation memo may be discoverable.

3. *Backup Tapes*

One recurring issue is what to do about disaster recovery backup tapes. Many companies routinely recycle these, causing the data on the tapes to be overwritten. When a company learns of a government investigation, the question arises as to whether the company should continue to recycle these backup tapes. In the *Zubulake* case, the court said a company clearly did not need to preserve every e-mail and every backup tape upon recognizing the threat of litigation, and that such a rule would "cripple large corporations[.]"⁴ However, the Committee Notes to the newly revised Rule of Civil Procedure 37(f) also suggest that where backup tapes may be the sole source of discoverable information, affirmative steps may be required to preserve the tapes.⁵ The best course may be to discuss and negotiate these issues with the government at the outset, since the government could have a very different view from the company about what should be maintained. In some recent subpoenas, the government has provided explicit instruc-

⁴ *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 217 (S.D.N.Y. 2003).

⁵ RULE 37(f) now states, "Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good faith operation of an electronic information system." See PROPOSED AMENDMENT TO FEDERAL RULE OF CIVIL PROCEDURE 37(f) (as adopted by the Judicial Conference of the United States, Sept. 20, 2005). The Committee Notes to PROPOSED RULE 37(f) state (in pertinent part): "Whether good faith would call for steps to prevent the loss of information on sources that the party believes are not reasonably accessible under Rule 26(b)(2) depends on the circumstances of each case. One factor is whether the party reasonably believes that the information on such sources is likely to be discoverable and not available from reasonably accessible sources." *Id.* While these Federal Rules of Civil Procedure are not directly applicable in a criminal case or grand jury investigation, it seems likely that the new electronic discovery rules will influence the practices of lawyers, and rulings of courts, in criminal and grand jury matters.

tions concerning what it wants the company to preserve.⁶ If the company has not received a subpoena and does not yet wish to initiate contact with the government to discuss preservation or other issues, counsel may wish to consider implementing some of the measures identified by the court in *Zubulake*: making a mirror image of the computer system at the time the duty to preserve is attached; retaining all then-existing backup tapes for the relevant personnel; and cataloging any later-created documents in a separate electronic file.⁷

4. Documentation of Ongoing Steps To Preserve Documents

Actions taken now and the reasons for those actions may be questioned later. Documenting the rationale for decisions when they are made may help to show that efforts were in good faith. In addition, the government sometimes will request the company to outline the steps that were immediately taken upon service of the subpoena to preserve electronic data, including the identification of groups of employees who were instructed to preserve data.

5. Departing Employees

Ensure that there is a procedure in place for departing employees who may have responsive documents on their computers. The company may have a practice of wiping clean the computer hard drives of departing employees so the computers can be recycled. Find out whether such a practice exists, and, if it does, make sure hard drives are imaged before they are recycled.

⁶ In a recent subpoena issued by the Antitrust Division of the Department of Justice, the subpoena requested the company to stop any activity that might result in the loss of electronic data, including rotation, destruction, overwriting, and/or erasure of such media in whole or in part. The subpoena said the request was intended to cover all removable electronic media used for data storage, including magnetic tapes and cartridges, magneto-optical disks, floppy diskettes, CDs, DVDs, and USB thumb drives. The subpoena also said that the company should not dispose of any electronic data storage devices and media that may be replaced due to failure and upgrade. With respect to local-user hard drives on personal computers and handheld devices, the subpoena said the company should not alter or erase this data and should not perform procedures such as data compression and disk defragmentation, optimization routines, or reassignment of hard drives, that might affect the data unless a true and correct copy had been made of the active files as well as all directory listings (including system files) for all directories and subdirectories. Finally, the subpoena requested the company to preserve copies of all custom application programs and custom database programs used to process electronic data responsive to the subpoena.

⁷ See *Zubulake*, 20 F.R.D. at 218.

C. Discussion with Government Attorney

1. Status of Company as Witness/Subject/Target

Not long after receiving a subpoena, in-house or outside counsel for the company should contact the government attorney in charge of the investigation. Counsel should inquire as to the status of the company and its employees (witness, subject, or target)⁸ and try to find out as much as possible about the investigation. Some government attorneys are more forthcoming than others, and may even provide “nontarget” or “nonsubject” letters. SEC attorneys generally will not indicate whether a company is a subject or target and will say that, unlike the Department of Justice, the SEC does not use these labels. Nevertheless, counsel may be able to obtain useful information from the SEC about how the company is viewed.

On occasion, an inexperienced prosecutor may not recognize the distinction between a “target” and “subject” and, therefore, inaccurately characterize a company or person as a “target.” Such a prosecutor is likely also ignorant of the reporting obligations that may exist for a public company that is informed that it is a “target” of a government investigation. Counsel may need to educate the prosecutor on these issues in order to understand the true status of the company and ensure that the prosecutor has not used the “target” terminology too loosely. A reasonable prosecutor who understands the definition of a “target” and the possible reporting obligations for a public company that is so labeled may be willing to defer deciding whether a company is a “target” until late in the investigation. Of course, this also gives counsel more time to discuss the facts and law with the prosecutor in an effort to show that the company is not deserving of “target” status.

⁸ The U.S. Attorneys’ Manual defines a “target” as “a person as to whom the prosecutor or the grand jury has substantial evidence linking him or her to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant.” The Manual defines a “subject” as “a person whose conduct is within the scope of the grand jury’s investigation.” “Advice of ‘Rights’ of Grand Jury Witnesses,” United States Attorneys’ Manual, tit. 9, § 11-151, available at <http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/11mcrim.htm#9-11.151> (last visited Jan. 2, 2007). Of course, a prosecutor is free to change a person or entity’s status from subject to target on the basis of new information.

2. Negotiating Scope/Return Date of Subpoena

Often, the government drafts a subpoena with very broad language (covering every conceivable document) and specifies a “return” date within only a few weeks. The government fully expects the company’s attorney to negotiate not only the scope of the subpoena but the return date. It is not unusual for the government to agree preliminarily to limit the production as long as all documents are preserved so they may be produced at a later time, if needed. The government also will often agree to a reasonable extension of time to produce the documents or to a “rolling” production. It may be preferable to delay discussion of specific proposals until counsel has had time to assess the volume of records called for under the subpoena and the time and burden involved in producing them. This information should be gathered as quickly as possible. Any agreement to limit the scope of a subpoena should be clearly documented in a letter to the government.

3. State Sunshine Laws

If the document request or subpoena is from a state agency, counsel for the company should inquire (or research) whether the particular state has a “Sunshine Law” that provides for public access to certain records and meetings. Under expansive Sunshine Laws, such as those in the state of Florida, documents that a company produces to the government during an investigation, as well as letters and other communications with the government, may be (or may later become) publicly available.⁹ It is important that counsel understand the state law provisions, including any exemptions, before company records are produced so that everything possible may be done to protect the records that are produced from public disclosure.

D. Alerting the Board of Directors and/or Audit or Other Committees

If it appears that the company or a senior officer is a target of the investigation, or the company otherwise has significant exposure, counsel likely will want to schedule a meeting of the Board of Directors and/or Audit Committee or other relevant committees to apprise them of the govern-

⁹ FLA .STAT. § 119.07 (making documents received by the state government in connection with official business subject to public inspection and copying, including records related to a criminal investigation once the investigation is no longer active).

ment’s investigation. Counsel may also wish to discuss any corrective actions that have been taken or are under consideration. Keep in mind that communications with the Board and/or committees—whether reflected in memos, meeting minutes, e-mails, or notes—may be discoverable. To the extent that portions of Board minutes or other documents summarize privileged legal strategy, the documents should be so designated. In any event, the Board will benefit if meeting minutes reflect the careful review that the Board has given the alleged wrongdoing and the actions taken in response.

Depending upon the circumstances, and particularly if there are allegations of misconduct by senior management, the Board may decide to conduct its own internal inquiry. Internal investigations are discussed later in this monograph.

Sometimes individual directors, officers, or others may ask whether it is advisable to contact a politician or other person with perceived influence or “clout” to intervene on the company’s behalf. Even if the influential person were willing to intervene, such contact in most situations does more harm than good.

E. Restrictions on Trading in the Company’s Securities

Depending upon the situation and particularly if the government is investigating possible misconduct by senior officers, it may be advisable to prohibit trading in the company’s securities by the company and those with knowledge of the investigation while the investigation is active.¹⁰

F. Disclosure Issues

Upon learning of a government investigation, the company and its “Disclosure Committee” if there is one must consider a myriad of disclosure issues likely to arise: (a) Must the investigation be disclosed? (b) Must

¹⁰ As the Supreme Court explained in *United States v. O’Hagan*, 521 U.S. 642, 651-52 (1997), “[u]nder the ‘traditional’ or ‘classical theory’ of insider trading liability, § 10(b) and Rule 10b-5 are violated when a corporate insider trades in securities of his corporation on the basis of material, nonpublic information. Trading on such information qualifies as a ‘deceptive device’ under § 10(b).”

any of the facts, events, and conduct that are being investigated be disclosed? (c) If the company is about to make any public statements or filings, are these in need of modification or supplementation in light of recent events? (d) Do any past statements or claims made by the company need to be corrected or supplemented on the basis of what has been learned? (e) Should the company's outside auditors be informed of the investigation or underlying facts? (f) Are there any reporting obligations under the Sarbanes-Oxley Act or other laws?

While corporations do not have a general affirmative obligation to publicly disclose all material information under the federal securities laws, they and their insiders generally may not trade in the corporation's securities while aware of material nonpublic information. In addition, they must publicly disclose any material information necessary to correct any untrue statement of a material fact or to make any statements they do make, in light of the circumstances under which they were made, not misleading.¹¹ Finally, they must comply with the SEC's prospectus and periodic reporting requirements. These requirements, among other things, mandate disclosure of any material legal proceedings known to be contemplated by governmental authorities.¹² Also, the listing standards of the NYSE and other exchanges generally require the prompt disclosure of material information.

Given the gravity and complexity of these types of disclosure and reporting issues, and the need to continually reassess them as the investigation progresses and new facts come to light, counsel is well advised to consult with a specialist on such issues.

1. Whether To Publicly Disclose the Investigation

Some of the factors to consider in assessing whether disclosure of the investigation is required include (1) whether the investigation will materially impact the company's performance and prospects; (2) the likelihood that the investigation will result in formal charges; and (3) the likely impact of any charges on the company or on the market for its securities. For a small company, the defense costs, if not covered by a Directors & Officers

¹¹ See, e.g., Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2000); 17 C.F.R. § 240.10b-5-1 (2005).

¹² SEC Regulation S-K, item 103.

("D&O") insurance policy, could potentially be material to the company's performance results.

In some circumstances, companies opt to publicly disclose the existence of a government investigation in the very early stages even though there may not be an affirmative duty of disclosure under federal securities or other laws.¹³ Companies may disclose early because they seek to control the nature of the disclosure rather than run the risk that the investigation will be leaked to the media, putting the company in a reactive posture. Such companies also seek to avoid possible third-party claims that the company did not disclose early enough. If disclosure is made, counsel must be prepared for the resulting onslaught of questions from analysts, reporters, shareholders, suppliers, and creditors who will press for details. It is also possible that shareholder class actions and derivative actions will be filed. In responding to inquiries about the investigation, the company must balance its desire to fully respond with the need to avoid premature disclosures that may later turn out to be inaccurate and thus expose the company to potential liability.

Sometimes companies elect not to disclose an investigation unless and until they receive an indication from the government that the investigation will go beyond a request for documents, and the government believes wrongdoing has occurred. For example, in the context of an SEC investigation, some companies have opted not to disclose the receipt of a document request from the SEC and instead have waited to disclose until they have received a Wells Notice indicating the SEC's intent to pursue a claim against the company or one of its officers, or until the SEC has indicated a desire to take testimony from employees. In making the disclosure decision, companies sometimes are influenced by whether there are other

¹³ For example, on July 11, 2005, DreamWorks Animation SKG, Inc. announced in its Form 8-K (under "Other Events") that it had issued a press release the same day stating (among other things) that "it has received a request from the staff of the Securities and Exchange Commission and is voluntarily complying with an informal inquiry concerning trading in its securities and the disclosure of its financial results on May 10, 2005. The Company stated in the press release that it intends to cooperate fully with the inquiry." Available at <<http://www.sec.gov/Archives/edgar/data/1297401/000119312505140804/d8k.htm>> (last visited Jan. 2, 2007). In a Form 10-Q filed on August 12, 2005, Dreamworks again referenced the SEC's informal inquiry (under "Legal Proceedings") and added: "The SEC has informed us that the informal investigation should not be construed as an indication that any violations of law have occurred. We are cooperating fully with the inquiry." Available at <<http://www.sec.gov/Archives/edgar/data/1297401/000119312505167077/d10q.htm>> (last visited Jan. 2, 2007).

similarly situated companies that have made disclosure, as well as whether customers, suppliers, or others are likely to be affected by the disclosure or the investigation itself.

Even if the company elects not to disclose the investigation, the company must take care not to falsely deny the existence of an investigation. Therefore, the company's officers and spokespersons should be alerted about how to respond in the event that a question is ever posed about the investigation. If possible, such advice should be in writing, lest it be misconstrued or mischaracterized.

2. Accuracy of Imminent Public Statements/Filings

At the point when counsel learns about a government investigation, the company may be about to announce financial results, or file a quarterly or annual report on Form 10-Q. Perhaps the chief executive officer is about to have a teleconference with analysts. Counsel should consider whether any of the public statements that are about to be made need to be modified or supplemented in light of the company's knowledge of the government's investigation or any of the underlying facts.

Keep in mind the content of any merger or other agreements that are filed with, or incorporated by reference into, proxy statements, registration statements, or other SEC filings. Such agreements may contain provisions that represent, for example, that the company has not taken any action that would cause the company to be in violation of the Foreign Corrupt Practices Act¹⁴ or other law. Even if the agreement was not prepared as a disclosure document, if it is made public or disclosed to shareholders, it may be actionable by the SEC.

3. Correcting Past Statements and/or Claims

Counsel should also consider whether any new information learned by the company necessitates the correction or supplementation of past financial statements, filings, or claims of the company. For example, it may be necessary to correct a past financial statement or amend a past disclosure or registration document that can no longer be considered correct and be relied on by investors.

¹⁴ 15 U.S.C. §§ 78dd-1 *et seq.*

It may also become necessary to correct past reports or claims submitted to the government. For example, a health care provider that learns from an internal investigation that the company received payments to which it was not entitled may need to disclose and refund the overpayment so as not to run afoul of the criminal law.¹⁵

4. Disclosures to Outside Auditors

The securities laws prohibit officers and directors and those acting under their direction from coercing, manipulating, misleading, or fraudulently influencing the corporation's auditors when they know that their actions, if successful, may cause the financial statements to be materially misleading.¹⁶

If the government's investigation involves a possible accounting impropriety, the company will likely advise the outside auditor of the investigation early in the process and consult with the auditor on the scope and mechanics of any internal investigation that follows. This is done because the auditor will need to decide for itself whether the scope of the internal investigation is sufficient so that the auditor may issue any current audit report and continue to rely on management's representations.¹⁷ Depending upon the circumstances, the auditor may also have to consider the need to withdraw a prior opinion.

Even if the government investigation does not involve an accounting impropriety, if it raises questions about management integrity or the adequacy of internal controls, the auditor will expect to be informed and will likely seek detailed information concerning the results of any internal investigation and supporting documents. In responding to such a request, counsel must balance the danger of waiving attorney-client privilege and even work prod-

¹⁵ 42 U.S.C. § 1320a-7b(a)(3) makes it a felony for a person "having knowledge of the occurrence of an event affecting his initial or continued right to payment" to "conceal[] or fail[] to disclose such event with an intent fraudulently to secure" the payment.

¹⁶ Section 303(a) of the Sarbanes-Oxley Act of 2002, implemented by Rule 13b2-2(b)(1). See SEC Release No. 34-47890 (effective June 26, 2003), 17 C.F.R. § 240.13b2-2 (2005).

¹⁷ Section 10A of the Securities Exchange Act of 1934 states that if, in the course of an audit, a registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the firm shall, in accordance with generally accepted auditing standards, determine whether it is likely that an illegal act has occurred. If it has, the firm must determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages. 15 U.S.C. § 78j-1.

uct protection against the consequences of refusing auditor demands for materials.¹⁸

5. Reporting Obligations under Sarbanes-Oxley and Other Federal Laws

In a public company, if an in-house lawyer learns of credible evidence of wrongdoing (a “material violation”) by the company or its directors, officers, employees, or agents, there may be a duty under the Sarbanes-Oxley Act to report this information up the ladder. The scope of the covered laws is broad, including (a) breach of a fiduciary or similar duty to the Issuer (of securities) under federal or state law; (b) violation of federal or state securities laws; and (c) violation of any other federal or state law.¹⁹ Other federal statutes may also require disclosure of wrongdoing to the government, depending upon the circumstances.²⁰

G. Insurance Carrier Notification

In coordination with the company’s insurance department, counsel should review the applicable policies to determine whether coverage may exist for individual officers or directors or the company itself, as well as for the cost of an internal investigation, and what notification is required. If coverage exists, the insurer must be given notice not only of actual claims but circumstances likely to give rise to a claim. However, if the insurer disputes the existence of any obligation toward the defense of the company, provid-

¹⁸ Disclosure of attorney-client communications to auditors will waive the privilege for those communications and, possibly, for other undisclosed attorney-client communications on the same subject. Whether disclosure of work product to auditors will result in a waiver is open to question and turns on whether the outside auditor is an adversary or is likely to reveal the company’s information to an adversary. Courts differ on this issue. See BERWIN COHEN, ROBERT T. DUFFY & LARRY R. LANGDON, PROTECTING A PUBLIC COMPANY’S CONFIDENCES 86-89 (National Legal Center for the Public Interest Feb. 2005).

¹⁹ 17 C.F.R. part 205. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, SEC Release No. 33-8185 (Sept. 26, 2003). These Final Rules were promulgated pursuant to section 307 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7245), which was signed by President Bush on July 30, 2002. For an in-depth discussion of this topic, see SABINO (ROD) RODRIGUEZ III & ROBERT KNUTS, REPRESENTING THE PUBLIC COMPANY: A POST-SARBANES-OXLEY GOVERNANCE PARADIGM FOR IN-HOUSE LAWYERS AND OUTSIDE COUNSEL (National Legal Center for the Public Interest Jan. 2004).

²⁰ See, e.g., 41 U.S.C. §§ 53, 57(c) (requiring the reporting of kickbacks related to government contracts).

ing privileged or confidential information to the insurer could waive protections for those materials. Counsel should seek acknowledgment of the insurer’s defense obligations, establishing a common interest/joint defense between the insurer and the insured in order to protect any privileges for exchanged documents. As the government’s investigation progresses, counsel should also consider the coverage implications of any actions that are being contemplated. For example, if a company admits that certain of its financial statements were false, and those very financial statements were given to an insurance company as part of the process of applying for insurance, the insurance company may attempt to rescind coverage.

Counsel should also be careful to obtain all necessary consents from the insurance company. D&O policies typically contain cooperation clauses that contractually prohibit or require insurer consent to any admission of liability, as well as to selection of counsel and any settlements. Keep in mind that, in at least one recent deferred prosecution agreement, the government required the company to represent that the fine paid by the company was not covered by insurance and to agree that, if coverage existed, fifty percent of any insurance payment would be remitted to the United States.²¹

H. Actions with Respect to Possible Wrongdoers

In some instances, the company may need to consider the imposition of restrictions on, or additional oversight of, the activities of employees or officers suspected of improper conduct until sufficient information is gathered to know whether the suspicions have any basis. Ultimately, if the company obtains evidence of wrongdoing, it may wish to dismiss or discipline the individuals, though it must also consider whether any actions that are taken will create adverse evidence against the company in related civil litigation. In terms of demonstrating cooperation, however, the SEC has said that it considers whether the company has taken disciplinary

²¹ See Deferred Prosecution Agreement entered into by KPMG and the United States Attorney for the Southern District of New York, dated Aug. 26, 2005, at ¶ 5.

action against wrongdoers.²² Similarly, the Department of Justice has said that, in considering whether to bring charges and negotiating plea agreements with companies, prosecutors must consider the corporation's remedial actions, including efforts to replace responsible management and discipline or terminate wrongdoers.²³

At the same time, employees may have rights that the company must consider in order to avoid future employment claims. For this reason, companies sometimes consult employment counsel to evaluate all the options and avoid a quick termination. Moreover, if the ostensible wrongdoer claims to be or may qualify as a whistle-blower, any efforts to discipline the individual could lead to the filing of a complaint and an investigation in which the company must show by clear and convincing evidence that the reason for taking adverse action was not related to the alleged whistle-blowing activity. An employee who prevails is entitled to seek reinstatement, back pay with interest, attorneys' fees, and other damages.²⁴

²² See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, SEC Release No. 44969 (Oct. 23, 2001), Accounting and Auditing Enforcement Release No. 1470 (Oct. 23, 2001), available at <<http://www.sec.gov/litigation/investreport/34-44969.htm>> (last visited Jan. 2, 2007) ("Seaboard Report"). In the Seaboard Report, the SEC announced that it was not taking any action against Seaboard (the parent company) in a case in which the controller had caused the books and records to be misstated and then covered up those facts. The SEC identified criteria that it said it would consider in determining "whether, and how much, to credit self-policing, self-reporting, remediation and cooperation." These criteria included: "Are persons responsible for any misconduct still with the company? If so, are they still in the same positions?" In Seaboard, the company terminated its former controller within 12 days of learning of misconduct. It also terminated two employees responsible for supervising the controller. See also SEC Charges Royal Ahold (Oct. 13, 2004) (the "Commission did not seek a penalty from Ahold because of, among other reasons, the company's extensive cooperation with the Commission's investigation. Ahold self-reported the misconduct and conducted an extensive internal investigation. . . . Ahold promptly took remedial actions including, but not limited to, revising its internal controls and terminating employees responsible for the wrongdoing."), available at <<http://www.sec.gov/news/press/2004-144.htm>> (last visited Jan. 2, 2007).

²³ See Memorandum from Paul J. McNulty, Deputy Attorney General, on Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), available at <http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf> (last visited Jan. 2, 2007) ("McNulty Memo"), at 4. The memorandum states that it provides "internal Department of Justice guidance" only. *Id.* at 19. The cover letter to the memorandum notes that the McNulty Memo is intended to supersede and replace the Thompson Memorandum that preceded it.

²⁴ See section 302 of the Sarbanes-Oxley Act (codified at 18 U.S.C. § 1514A). Under this provision, public companies are prohibited from retaliating against an employee for providing to certain parties, including someone within the company who has the authority to investigate, information that the employee reasonably believed constituted a violation of federal fraud statutes or securities laws. If a complaint is filed, the Department of Labor

I. Assessing the Need for Remedial Measures

The company should consider whether there is a need to review the compliance program to determine what led to the events at issue and whether any changes should be made to avoid a recurrence. Such a review may even be required under the existing compliance program. Potential remedial measures may involve improving internal controls, devising new policies and procedures, or requiring better training on existing policies. One issue to discuss is whether the review will be done by the chief compliance officer or by attorneys conducting an internal investigation, and whether the company desires to claim privilege for the results of the review.

As noted previously, there may be disclosure obligations for the company under the Sarbanes-Oxley Act and other federal securities laws (e.g., reporting on material deficiencies in financial controls that contributed to the losses). Even apart from any disclosure obligations, it is desirable for the company to identify and remedy any weaknesses in the compliance program. Among other benefits, the company will be looked upon more favorably by the government if it does so. One of the factors considered by the SEC in assessing the extent of a company's cooperation is whether there are "assurances—in the form of internal controls and compliance procedures—that the misconduct will not be repeated."²⁵ Similarly, the Department of Justice considers whether the corporation has taken remedial actions, including any efforts to implement an effective corporate compliance program or improve an existing one.²⁶

Corrective action may also help shield the company and the Board from future liability for failing to respond to warning signals of compliance problems that existing internal controls had not flagged. Finally, under the *Federal Sentencing Guidelines*, a company's "culpability" score may be reduced if it has an effective compliance and ethics program, and one of the minimal requirements is that, "[a]fter criminal conduct has been detected,

must conduct an investigation, and the employer must show by clear and convincing evidence that it would have taken the same unfavorable employment action even in the absence of the whistle-blowing activity.

²⁵ Seaboard Report, *supra* note 22. In Seaboard, the company implemented several new controls to strengthen its financial reporting processes and to prevent a recurrence.

²⁶ McNulty Memo, *supra* note 23, at 4 (item 6).

the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program."²⁷

J. Preparing for the Possibility of Media Coverage

Even prior to any public disclosures of the investigation, counsel must be prepared for the possibility that the investigation will be leaked to the press and reported in the media. This may well lead to adverse market reaction and shareholder lawsuits. Unfortunately, it may also make it more difficult for the government to terminate an investigation without taking action. Some companies retain a public relations consultant with specific experience in assisting companies in such circumstances. Communications with the consultant are likely to be discoverable; however, if the consultant clearly has been retained by counsel in anticipation of litigation or to assist counsel in providing legal advice to the company, the communications may be found to be privileged.²⁸

Companies also typically designate a single spokesperson for the company, and direct employees to refer all inquiries to the spokes-person. Any prepared statements from the company to the media concerning the investigation must be carefully worded so the statements are both accurate and appropriate for the multiple audiences that will read them, including the government. As noted previously, the company should take care not to directly or indirectly deny the existence of the investigation. Counsel should be equally careful with any statements made about the investigation to employees and others.

The company may wish to consider whether media coverage could have any impact on relationships with lenders, suppliers, and customers, and prepare a response plan. If it is possible that the government will contact these

²⁷ See FEDERAL SENTENCING GUIDELINES MANUAL § 8B2.1(b)(7) (2005) (Effective Compliance and Ethics Program).

²⁸ See, e.g., *In re Grand Jury Subpoenas Dated Mar. 24, 2003 Directed to (A) Grand Jury Witness Firm*, 265 F. Supp. 2d 321 (S.D.N.Y. 2003) (Judge Kaplan); *In re Copper Market Antitrust Litig.*, 200 F.R.D. 213 (S.D.N.Y. 2001) (finding privilege). *But see Calvin Klein Trademark Trust v. Wachner*, 198 F.R.D. 53 (S.D.N.Y. 2000) (denying privilege).

third parties as part of the investigation, counsel should discuss whether it is advisable to alert them to the investigation. If disclosure is made to some but not all of these third parties, this may prompt accusations that some received more favorable treatment than others.

K. Notification to Employees of Possible Contact by the Government

If the government has not done so already, it may seek to interview employees by contacting them directly at home or the office. The company will also likely wish to interview employees with knowledge of the events under investigation. We describe the warnings that should be given to employees prior to conducting these interviews, and provide other suggestions for the interviews, in the discussion of Internal Investigations (section M.5.b).

In appropriate circumstances, it may be advisable to send a letter or memo to affected employees as soon as possible to alert them that they may be contacted by the government. This may be done for convenience (if there are many employees who need to be notified), and to ensure a clear record of what was communicated. As is discussed in more detail below, the content of such a letter or memo will vary depending upon whether company policy requires employees to cooperate with the government's investigation. In any event, it is imperative that nothing be said that could be construed as a directive not to cooperate with the government or as a suggestion of what the employee should say during an interview.

1. Advising Employees of Rights and Company Requests

In a situation in which the company is remaining neutral and not requiring employees to submit to a government interview as a condition of continued employment, a letter to employees may include some or all of the following:

General description of the investigation (e.g., "The company recently received a grand jury subpoena calling for the production of certain records relating to the sale and marketing of our products. At this point, we do not know the scope or duration of the investigation or the exact nature of its subject matter. Nevertheless, the existence of the investiga-

tion raises the possibility that government investigators may attempt to contact company employees, either at work or at home.”)

Employees’ rights (e.g., “If you are contacted, you should bear in mind that a government investigator cannot require an individual to submit to questioning. You are, of course, free to speak with a government investigator, but you are under no obligation to do so. The decision is entirely up to you.”)

Request to notify company prior to interview so company attorney may be present (e.g., “The company requests that any employee who is contacted by a government investigator immediately notify _____ at _____ before proceeding with an interview. The purpose of this request is to allow the company’s attorney to be present for the interview (if you decide to go forward with an interview) so that the company’s interests are represented and an accurate record will be made of what the government agents tell you. Your compliance with this request, however, is entirely up to you.”)

Suggested information to request of government investigator (e.g., “If you are contacted by an individual who claims to represent the government, you may wish to: (a) Ask for identification and a business card; (b) Determine precisely why the individual wishes to speak with you; (c) Consider telling the individual that you want to schedule the interview at a later date. This will give you sufficient time to confirm the identity of the individual; determine whether you want to go forward with the interview; and arrange for the Company attorney or some other attorney to be present if you so desire.”)

Reminder to tell the truth (e.g., “If you choose to be interviewed, you should remember the following important facts: (a) Make certain you obtain the names, titles, telephone numbers and addresses of everyone present who claims to represent the government. Get their business cards, if possible; (b) Always tell the truth. You should know that you can be prosecuted for not telling the truth to government investigators, even if you are not put under oath.”)

Right to have counsel/witness present for interview (e.g., “You have the right to have an attorney present during this interview. At a minimum, you should have a friend or relative present for the entire interview

so that you will have a witness if there is ever any dispute about what you said or what you were asked.”)

Right to take notes (e.g., “You have the right to take notes and keep them private. If you take notes, include the questions being asked and your answers.”)

2. Requesting/Insisting that Employees Cooperate

Rather than remain neutral, companies sometimes have informed employees that the company expects them to cooperate fully with the government. The company may even have a written policy that requires employees to cooperate with the government on matters pertaining to the company.²⁹ In the Seaboard Report, the SEC stated that one of the questions that it asks when weighing what action, if any, to take against the company is, “[d]id the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?” Invocations of the Fifth Amendment privilege against self-incrimination by an employee (and perhaps even an ex-employee) may, in some cases, be used by the government to draw adverse inferences against the company in a civil proceeding, including one to which the government is a party.³⁰ The company itself cannot invoke the Fifth Amendment privilege since the privilege generally does not extend to corporate records. If a company takes the position that employees are expected to cooperate with the government’s investigation, the company will have to consider what action, if any, to take against employees who decline to cooperate with the government’s (and the company’s) investigation.

In one recent case, a court found that a company, in an effort to avoid indictment, succumbed to pressure from the government to force employees to make statements to the government by conditioning the advancement of legal fees to these employees on their cooperation with the government

²⁹ See WALL ST. J. (Mar. 22, 2005) (“American International Group, Inc. fired two top executives after the men signaled they would invoke their Fifth Amendment rights against possible self-incrimination as regulators investigate whether AIG manipulated its books to mislead investors, people familiar with the matter said.” “Both men ‘were terminated pursuant to company policy that requires employees to cooperate with government authorities on matters pertaining to the company,’ said AIG spokesman Chris Winans.”)

³⁰ See, e.g., *Brink’s, Inc. v. City of New York*, 717 F.2d 700 (2d Cir. 1983); *RAD Servs., Inc. v. Aetna Cas. & Sur. Co.*, 808 F.2d 271, 277 (3d Cir. 1986); *LiButti v. United States*, 107 F.3d 110, 121 (2d Cir. 1997) (setting forth a multifactor analysis).

investigation and by not invoking their Fifth Amendment rights. The employer also determined that no legal fees would be advanced to any employee who was indicted. Some of the employees who made statements to the government and were later indicted moved to suppress their statements. In a scathing opinion, the court held that the government had violated the employees' constitutional rights to a fair trial and assistance of counsel, granting the indicted employees' motion to suppress.³¹ The Department of Justice has since changed the guidance given to prosecutors on the fee issue; prosecutors are no longer to take into account whether a company is advancing attorneys' fees except in "extremely rare cases" where this is intended to impede the investigation.³²

L. Coordinated Defense Efforts and Payment of Defense Costs

1. *Employees Who Are Witnesses*

Where the government seeks to question employees who are described by the government as mere witnesses, the question may arise as to whether the same attorney may represent the company and these employees. Even assuming there is no apparent conflict that forecloses multiple representation, the analysis should not stop there. If the employee's interests later become adverse to the company, counsel may be conflicted out of continuing to represent the company. There is also a danger of the attorney disclosing to the company privileged communications with the employee without consent, or vice versa. This danger can be lessened if the attorney obtains an agreement from both clients consenting to the sharing of material information between them.

There are other reasons to avoid joint representation. Some government attorneys view joint representation as an effort by the company to "circle the wagons" and shape the facts revealed by the witnesses. Their resulting

³¹ See *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006). The case involved tax fraud allegations against a number of KPMG accountants and others. The court held that "the government here coerced KPMG to apply pressure . . . in order to secure waivers of constitutional rights that the government itself could not obtain. That goes beyond the bounds of appropriate government action." *Id.* at 333. The lower court also opened an ancillary civil proceeding to allow the indicted employees to sue KPMG for the payment of their legal bills. *United States v. Stein*, 435 F. Supp. 2d 330, 382 (S.D.N.Y. 2006).

³² McNulty Memo, *supra* note 23, at 11.

skepticism of information provided by these witnesses may cause the government attorneys to discount testimony that is favorable to the company. In fact, the Department of Justice has given as an example of conduct that "impedes" an investigation (even if it does not rise to the level of criminal obstruction) "overly broad assertions of corporate representation of employees or former employees."³³ To avoid these types of concerns, companies sometimes agree to pay the legal fees of one or more separate attorneys who are made available to represent all or subclasses of employees/witnesses, provided conflict rules permit this. It is also not unusual where both a parent and subsidiary are involved in an investigation for the companies to have separate counsel.

2. *Employees Who Are Subjects/Targets*

The government may indicate (or it may otherwise be obvious) that certain current or former employees are suspected of engaging in wrongdoing. Such individuals undoubtedly will need separate representation. The company must decide whether to advance the fees of attorneys who represent these individuals. If the individual in question is a director or an officer, the company may be required to advance defense costs pursuant to the company's bylaws or articles of incorporation, provided the individual signs an undertaking promising to repay the funds if he is later found not to be entitled to indemnification.³⁴ The bylaws for some companies state that legal fees will be advanced until a "final disposition," which arguably is until a conviction or, some would argue, until after an appeal of any conviction.

Absent a requirement in the company's organizational documents, the decision to advance defense costs is likely left to the discretion of the Board. If the company has no definitive evidence that the employee believed his/her conduct was unlawful, or that he/she was acting in a way opposed to the best interests of the company, the Board may decide to advance legal

³³ See *id.* at 12.

³⁴ Often a company's organizational documents provide that directors and officers (and perhaps employees) will be indemnified (after the fact) to the fullest extent permitted by law. Delaware law empowers a company to indemnify any person who was or is a party, or is threatened to be made a party, to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, including derivative actions asserted on behalf of the corporation. To be indemnified, however, a person must have acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of the corporation. To be indemnified in a criminal matter, that person must also have had no reasonable cause to believe his or her conduct was unlawful. See 7 DEL. CODE § 6426.

fees once an undertaking is signed. Some companies may opt to do so only as long as the employee is cooperating with the government.

3. The Government's View on Advancing Defense Costs

One issue to consider in deciding whether to advance defense costs (if this is discretionary) is how the government will view these payments. If the government possesses information that causes it to believe the individual seeking defense costs is a wrongdoer, the government may question how the company can claim to be cooperating and at the same time stand behind the wrongdoer by using corporate funds to pay for his defense. For a number of years, the Department of Justice's guidance to prosecutors was that a "factor to be weighed by the prosecutor [in deciding whether to charge a corporation] is whether the corporation appears to be protecting its culpable employees and agents . . . [including] through the advancing of attorneys' fees. . . ." if it was not required to do so under governing law.³⁵ In December 2006, however, the Department of Justice changed this guidance and instructed prosecutors that they "generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation or indictment" except in "extremely rare cases" where "the totality of the circumstances show that it was intended to impede a criminal investigation."³⁶ The guidance also states, however, that prosecutors may continue to ask questions about how and by whom attorneys' fees are paid for employees, since this may be necessary to assess other issues such as conflict of interest.³⁷ In addition, counsel should keep in mind that at least one state Attorney General reportedly reached a settlement agreement that prohibited companies from paying the legal fees of indicted employees unless its bylaws required it to do so.³⁸

³⁵ Memorandum from Larry D. Thompson, Deputy Attorney General, on Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at <http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm> (last visited Jan. 2, 2007) ("Thompson Memo"). See also Lucent Settles SEC Enforcement Action, SEC 2004-67 (May 17, 2004), available at <<http://sec.gov/news/press/2004-67.htm>> (last visited Jan. 2, 2007) (announcing charges against Lucent Technologies, Inc. and citing its "failure to cooperate" in part because, "[a]fter reaching an agreement in principle with the staff to settle the case, and without being required to do so by state law or its corporate charter, Lucent expanded the scope of employees that could be indemnified against the consequences of this SEC enforcement action. Such conduct is contrary to the public interest.").

³⁶ McNulty Memo, *supra* note 23, at 11.

³⁷ *Id.* at 11 & n.3.

³⁸ See David Hechler, *New York AG Presses Companies to Stop Paying Indicted Employees' Legal Bills*, CORP. COUNS., Nov. 2, 2006, available at <<http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1162375516746>> (last visited Jan. 2, 2007).

4. Joint Defense Agreements

Assuming that certain individuals retain separate counsel, the question may arise as to whether the company should enter into joint defense agreements with those individuals. While there may be benefits to such agreements, the company should think carefully about the conflict of interest issues and other potential ramifications before doing so. For example, if the company obtains information from an employee in the context of a joint defense agreement, it may be foreclosed from divulging this information to the government as part of its cooperation.³⁹ In addition, the government typically views joint defense agreements with suspicion, as a device to coordinate on a uniform version of events, and even to protect culpable employees by providing them with information about the government's investigation.⁴⁰ For these and other reasons, the company should also think carefully before entering into joint defense agreements with other companies that may be the focus of the same investigation.

³⁹ *United States v. LeCroy*, 348 F. Supp. 2d 375 (E.D. Pa. 2005). One representative of the Department of Justice expressed the view that "[i]f the joint defense agreement puts the corporation in a position where it is unable to make full disclosure about the criminal activity, then no credit for cooperation will be factored in." The representative added: "[I]t is hard for me to understand why a corporation would ever enter into a joint defense agreement[.]" though he left open the possibility that a corporation potentially could make a sufficient disclosure despite limitations resulting from a joint defense agreement. See *Interview with U.S. Attorney James B. Comey Regarding the Department of Justice's Policy on Requesting Corporations under Criminal Investigation to Waive the Attorney Client Privilege and Work Product Protection*, UNITED STATES ATTORNEYS' BULLETIN (Nov. 2003), available at <www.usdoj.gov/usao/eousa/foia_reading_room/usab5106.pdf> (last visited Jan. 2, 2007).

In addition, if the interests of the company and individual diverge at some point, there may be conflict of interest issues that create the risk of the company's counsel being disqualified. See *United States v. Henke*, 222 F.3d 633 (9th Cir. 2000) (defense counsel had to withdraw from representation where, by virtue of a joint defense agreement, he obtained confidential information from another defendant who later became a government witness. Counsel had a conflict because of his inability to use the confidential information to cross-examine the former defendant when he testified at trial.).

⁴⁰ The McNulty Memo states that, in assessing the extent of a company's cooperation, a prosecutor may consider whether the company appears to be "protecting its culpable employees and agents." While acknowledging that "the cases will differ depending on the circumstances," the Memorandum indicates that a "corporation's promise of support to culpable employees and agents . . . through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation." McNulty Memo, *supra* note 23, at 11.

M. Conducting an Internal Investigation

Often the company or the Board will quickly initiate its own internal investigation of the allegations that the government is examining in order to determine whether the allegations are well founded and, if so, to understand the nature and scope of what occurred and take corrective measures. We provide below some suggestions for conducting an internal investigation and highlight some of the common issues that arise.

1. *Written Request for Investigation To Procure Legal Advice*

The entity that requests the internal investigation (e.g., Management, Board, Special Committee of the Board, Audit Committee) should authorize, in writing, the attorney's internal investigation. The letter should indicate that counsel is being retained to develop factual information for the purpose of providing advice concerning potential liabilities and claims against third parties and its own employees, as well as to defend the company in anticipated potential litigation, and to recommend future legal actions, such as improved compliance programs. The letter should indicate the existence of the government's investigation and any other basis for anticipating possible litigation.

2. *Who Should Oversee and Conduct the Investigation?*

Often internal investigations are overseen by a committee consisting solely of outside directors, and conducted by outside counsel with prior criminal or SEC experience. This is almost always the case if potential wrongdoing by high-level officers is being investigated. Other times, the circumstances may be such that in-house counsel conducts the investigation. In the event that outside counsel is retained, the government has made it clear that it gives more credence to investigations conducted by outside attorneys who do not have previous ties to the company. For example, the SEC has stated that it asks: "Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel?"⁴¹

⁴¹ See Seaboard Report, *supra* note 22.

Lawyers who conduct internal investigations should understand that they are under close scrutiny by the government. In November 2004, the (then) director of the SEC's Division of Enforcement stated that an area of "particular focus" of the Commission was the role of lawyers in internal investigations of their clients or companies because of concern that lawyers in some instances "may have conducted investigations in such a manner as to help hide ongoing fraud, or may have taken actions to actively obstruct such investigations."⁴²

It is paramount that counsel conducting the internal investigation solely represent the interests of the corporate entity and not any individual employee, officer, or Board member (sometimes these persons/entities will have their own attorneys). Failure to do this will undermine the credibility of the investigation and put the corporation at serious risk.

3. *Scope of the Internal Investigation*

The scope of the internal investigation typically mirrors that of the government's investigation unless there is good reason to make it more broad. To fulfill management's duty of care and satisfy the government, the investigation should be both thorough and probing. The SEC has said that, when considering whether to bring an enforcement action against a company, it asks (among other things): "Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior?" It also asks whether scope limitations were placed on any review that was done and, if so, what they were.⁴³

An internal investigation that overlooks relevant facts or is otherwise insufficient may lead to inaccurate disclosures to the government or even accusations that the company attempted to conceal wrongdoing. The Department of Justice, in assessing the level of a company's cooperation, considers "whether the corporation, while purporting to cooperate, has engaged in conduct intended to impede the investigation . . . [including]

⁴² Stephen M. Cutler, Director, Division of Enforcement, U.S. SEC, The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program, Speech at UCLA School of Law (Sept. 20, 2004), available at <<http://www.sec.gov/news/speech/spch092004smc.htm>> (last visited Jan. 2, 2007).

⁴³ See Seaboard Report, *supra* note 22.

making presentations or submissions that contain misleading assertions or omissions.⁴⁴

4. *Information To Be Gathered during an Internal Investigation*

In considering what information to gather during an internal investigation, it is helpful to review the following criteria that the SEC uses in determining whether and how much to credit a company's self-policing, self-reporting, remediation, and cooperation.⁴⁵

What is the nature of the misconduct? Did the misconduct result from inadvertence, an honest mistake, simple negligence, reckless or deliberate indifference to indicia of wrongful conduct, willful misconduct, or unadorned venality? Were the company's auditors misled?

How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?

Where in the organization did the misconduct occur? How high up in the chain of command was knowledge of, or participation in, the misconduct? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Is it symptomatic of the way the entity does business, or was it isolated?

How long did the misconduct last? Was it a one-quarter, or one-time, event, or did it last several years? In the case of a public company, did the misconduct occur before the company went public? Did it facilitate the company's ability to go public?

How much harm has the misconduct inflicted upon investors and other corporate constituencies? Did the share price of the company's stock drop significantly upon its discovery and disclosure?

How was the misconduct detected and who uncovered it?

⁴⁴ See McNulty Memo, *supra* note 23, at 12.

⁴⁵ See Seaboard Report, *supra* note 22.

5. *Interviews of Employees*

As part of an internal investigation, counsel will want to quickly identify and interview all of the employees who may have knowledge of the events under investigation. When possible, key documents should be reviewed beforehand as long as this will not unduly delay the interviews. These materials should include public filings, press releases, analyst presentations, and other public documents that may be relevant, as well as any documents requested by the government.

Keep in mind that circumstances may change and foreclose future questioning of certain employees, so counsel should be as thorough as possible during the interviews. In addition, counsel should be mindful that an employee who is interviewed may already be cooperating with the government and may even be a whistle-blower who has filed a *qui tam* lawsuit (sealed) against the company.

In conducting the interviews, consider these suggestions and issues:

a. **Person To Observe (“Witness”) the Interview**

It is often a good idea to have a witness present for employee interviews, particularly for interviews of key employees. The witness will be able to verify what was said during the interview in the event of any later allegation of witness tampering or of a dispute about what the employee said. The presence of a second set of ears will also enhance the accuracy of any interview notes and summaries that are made.

b. **Warnings**

Upjohn Warning: The employee should be told at the start of the interview that counsel represents the company (not the employee) and is interviewing the employee to gather information in order to provide legal advice to the company.⁴⁶ Counsel should explain that the interview is covered by the attorney-client privilege, and that this privilege belongs to and is controlled by the company. The employee should be told that the company has the right to keep the interview confidential, and that the company, but not the employee, may elect in the future to waive the privilege and

⁴⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.13(f) (2004) (“In dealing with an organization's . . . employees . . . a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.”).

disclose information from the interview to third parties, including the government.

This disclosure, commonly referred to as an “Upjohn warning,”⁴⁷ should prevent the employee from later claiming to have believed the attorney represented the employee during the interview, in an effort to invoke the attorney-client privilege and prevent the company from disclosing the employee’s statements to the government.⁴⁸ The interview notes should document that the *Upjohn* warning was given. Sometimes the warning is made in a letter from the general counsel or a designee that is distributed to all who will be interviewed.

Employees Asking If They Need a Lawyer: Counsel should anticipate that employees may ask during the interview whether they need or should get an attorney. If the employee’s interests are, or might become, adverse to the company’s, ethical rules prohibit counsel from offering any advice to an unrepresented employee other than that the employee should obtain counsel.⁴⁹ If there is no ethical obligation to affirmatively advise the employee to obtain an attorney, counsel may decide that it is not in the company’s interest to do so because, for example, advising an employee to obtain counsel might delay and interfere with the company’s efforts to learn what hap-

⁴⁷ *Upjohn v. United States*, 449 U.S. 383 (1981). In *Upjohn*, the Supreme Court held that communications made by employees to company counsel at the direction of superiors to secure legal advice from counsel were protected by the attorney-client privilege. The Court set forth guidelines, as opposed to a bright-line test, for determining when the privilege applies to an attorney’s communications with employees. These guidelines include: (1) whether the communications were made by corporate employees at the direction of superiors for the purpose of obtaining legal advice; (2) whether the communications contained information necessary for counsel; (3) whether the matters communicated were within the scope of the employee’s corporate duties; (4) whether the employee knew that the communications were for the purpose of the corporation’s obtaining legal advice; and (5) whether the communications were ordered to be kept confidential by superiors. *Id.* at 394-96.

⁴⁸ See *In re Grand Jury Subpoena: Under Seal*, 415 F.3d 333 (4th Cir. 2005).

⁴⁹ MODEL RULES OF PROF’L CONDUCT R. 4.3 cmt. 2 (1983) (“[T]he possibility that the lawyer will compromise the unrepresented person’s interests is so great that the Rule [4.3] prohibits the giving of any advice, apart from the advice to obtain counsel.”). The entirety of MODEL RULE 4.3 states:

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When a lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer’s role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.

pened and to cooperate with the government. Rather than give advice, counsel may elect to tell the employee that he/she is not able to advise the employee on the issue and that the decision of whether to consult an attorney is entirely up to the employee. Some companies, however, choose to inform employees that they have the right to request their own counsel be present during the interview even if the employees do not raise the issue. The company may or may not agree to pay for counsel. The approach may vary depending upon the particular situation of the employee being interviewed.

Zar Warning: The government has sometimes accused officers and employees of a company of obstructing justice (or conspiring to do so) based, in part, on their having misled and lied to those conducting the company’s internal investigation.⁵⁰ The government’s theory is that the employees know and intend that the false information given during the internal investigation will be presented to the government and thereby obstruct the government’s investigation.⁵¹ As a result of these cases, some counsel now warn employees that the information provided during the interview may be turned over to the government, exposing them to possible obstruction charges if their statements are not truthful.

Of course, giving such a warning may have a chilling effect and cause employees to decline to provide information. If the company conditions continued employment on cooperation with an internal investigation, the

⁵⁰ James K. Robinson & Adam S. Lurie, *Little White Lies*, LEGAL TIMES, Aug. 16, 2004, available at <www.cwt.com/assets/article/Robinson_Little_White_Lies_081604_Legal_Times.pdf> (last visited Jan. 2, 2007) (describing the prosecutions of Ira Zar, the former chief financial officer of Computer Associates International, and Martin Grass and other former executives of Rite Aid Inc.). See also the criminal information and indictment describing the charges against former senior officers of Computer Associates International, Inc., Ira Zar, and Sanjay Kumar, available at <<http://www.usdoj.gov/dag/cftf/chargingdocs/zarinfo.pdf>> (last visited Jan. 2, 2007). Finally, see *United States v. Singleton*, H-06-080, 2006 WL 1984467, at *5 (S.D. Tex. July 14, 2006) (summarizing the obstruction charges filed against an employee who “provided false information that [the company’s] outside lawyers used to create a written report that they submitted to the CFTC, the FERC, and the USAO.”).

⁵¹ *Singleton*, 2006 WL 1984467. In the *Singleton* case, the defendant filed a motion to dismiss the obstruction charge on a number of grounds, including that the alleged false statements were made to private attorneys hired by his employer rather than to federal officials or agents. *Id.* at *5. The court rejected this argument and found that the allegations were sufficient to “satisfy the requirement for an official proceeding” under 18 U.S.C. § 1512(c)(2), since they could raise the inference that the defendant “expected and thus arguably intended that his intentionally false statements would be supplied to the Federal government in connection with one or more of [the] identified official proceedings.” *Id.* at *6.

employee may ultimately agree to be interviewed but perhaps will ask for time to consult an attorney and to have the attorney present for the interview. In addition, by giving the warning, counsel arguably creates the potential for an obstruction charge where it might not otherwise have existed had the employee never been informed that his or her statements would (or might be) disclosed to the government. All of these considerations should be assessed in the context of the particular facts presented to determine whether the additional warning should be given.

c. Are Interviews with Employees Privileged?

Counsel's communications with lower-level employees may not be protected from disclosure as attorney-client communications, particularly in state court litigation or in federal court litigation where jurisdiction is based on diversity. For example, in Illinois, the courts have adopted a control group test for determining which employees within a corporation may have privileged conversations with counsel. The control group likely will be limited to senior management and employees that advise senior management on final decisions, and exclude employees who merely supply information.⁵²

Even if counsel's notes and summaries of interviews with certain employees are not protected by attorney-client privilege, they probably will be protected from disclosure as attorney work product absent a showing of substantial need and undue hardship. To enhance the likelihood that the interview notes and summaries will be deemed work product, counsel should avoid taking down verbatim statements of the employee and putting statements in quotation marks. In addition, counsel should not ask the employee to review or adopt the notes or summary. Finally, the attorney should feel free to intersperse comments reflecting the attorney's mental processes and legal analyses. As always, however, counsel should be mindful that these notes and summaries may someday be turned over to the government, either voluntarily or if a court finds them not privileged. Therefore, counsel may wish to refrain from judgmental statements.

⁵² *Consol. Coal Co. v. Bucyrus-Erie Co.*, 432 N.E.2d 250, 258 (Ill. 1982).

d. Beware of Disclosing Information/Documents during Interviews

Be cautious in deciding what information and documents to share with employees and other witnesses who are interviewed since the purpose of the interviews is to learn what the witness knows. In addition, to the extent that any privileged documents are shown to the witness, the documents may become discoverable. Keep a clear record of any documents that are shown to a witness.

e. Witness-Tampering Laws

Counsel should avoid any interview techniques that could possibly be construed by the government as an attempt to influence the witness's testimony or as witness tampering. Under the law, it is a felony offense to "engage in misleading conduct towards another person with intent to . . . influence . . . the testimony of any person in an official proceeding."⁵³ An official proceeding need not be pending or impending at the time of the offense. Therefore, "misleading conduct" is prohibited even prior to any government investigation. In one case, a general counsel was charged with obstruction based, in part, on coaching employees on how to answer questions without disclosing the company's improper accounting practice.⁵⁴

It is not entirely clear where the line is drawn between appropriate advice in the preparation of witnesses and misleading conduct intended to "influence" testimony. Is advising a witness to answer questions narrowly and not to volunteer information an effort to influence testimony or impede an investigation? How about advising a witness to assert the Fifth Amendment

⁵³ 18 U.S.C. § 1512(a)(2). Section 1512(b)(3) of this statute makes it unlawful to corruptly persuade another person, or attempt to do so, with the intent to "hinder, delay or prevent the communication to a law enforcement officer or Judge of the United States of information relating to the commission or possible commission of a Federal offense. . . ."

⁵⁴ In September 2004, the former general counsel of Computer Associates International, Inc. pleaded guilty to obstruction of justice arising from his "coach[ing] [employees] on how to answer questions [from the government and outside counsel] without disclosing the 35-day month practice." This was a practice of keeping books open at the end of fiscal periods to allow the company to create the appearance that it had met quarterly revenue and earnings estimates. The practice was so widespread that employees reportedly joked that the company had its own "35-day month." See Press Release, Department of Justice, Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges, (Sept. 22, 2004), available at <http://www.usdoj.gov/opa/pr/2004/September/04_crm_642.htm> (last visited Jan. 2, 2007) (announcing, among other things, the guilty plea of Stephen Woghin, the former general counsel and senior vice president of Computer Associates International, to securities fraud, conspiracy, and obstruction of justice).

privilege against self-incrimination? Some might argue that even legal conduct can be a violation of the obstruction statutes if improperly motivated. Because the statutes do not clearly differentiate between improper conduct and legitimate defense activity, counsel must balance the need to represent the client company zealously against the need to avoid interview methods that the government might deem overly aggressive or manipulative. To this end, counsel should consider reminding witnesses that any statements made to the government must be truthful.

f. Requesting Employees To Maintain Confidentiality

During or after the interview, employees should be informed that the company requests that they keep the conversation with the company's attorney confidential in order for the company to maintain its privileges. They should also be asked to refrain from discussing the subject matter of the investigation with anyone other than counsel and from creating any new documents or e-mails that discuss or comment on the investigation. Counsel may also wish to inform employees that they likely will be interviewed again, either by the company or the government, and will likely be asked to describe any conversations they have had with nonattorneys (whether in person, by telephone, or by e-mail) concerning the subject matter of the investigation.

Remind employees that all e-mails and other documents that discuss the subject matter of the investigation are being collected by the company as part of the investigation, and to respond to any requests from the government. Therefore, employees should exercise care not to destroy any such documents. In addition, to the extent that they generate any future e-mails or documents that pertain in any way to the investigation (even though they should not be discussing the investigation except with counsel), copies of these e-mails and documents must be forwarded to counsel for possible production to the government. This reminder may cause employees to think twice before sending future e-mails about the investigation.

6. Interviews of Former Employees and Other Outsiders

Sometimes persons with knowledge of the events under investigation are no longer employed by the company. Before contacting such individuals for information, counsel should consider whether the communications will be

privileged and the risk that the investigation may be leaked by such a person if it is not already a matter of public knowledge.

7. Use of Experts

It may become necessary to retain experts to conduct analyses as part of the internal investigation. As with outside counsel, experts should be independent of the company to enhance the credibility of their work. Experts should be retained by outside counsel and, at least preliminarily, should be retained as consulting or nontestifying experts.

8. Protecting Results of Internal Investigation and Related Materials

To enhance the likelihood that internal investigation documents will be protected from disclosure under the attorney-client privilege and/or work product doctrine, communications through nonlegal intermediaries should be avoided. Any findings and communications in the course of the investigation should be kept confidential and disclosed only on a "need to know" basis to senior corporate officers with the authority to act. If it is necessary to distribute documents to senior management or Board members, ask that the documents be returned after they have been reviewed. Counsel should also limit the involvement of people who are not necessary to the investigation, as anyone who gains knowledge becomes a potential witness.

9. Drafting an Internal Investigation Report and Related Materials

Sometimes a report of an internal investigation is not prepared since it may be unnecessary or unwise to do so in a given situation, although the absence of a report may engender suspicion on the part of the government. If the decision is made to prepare a report summarizing the results of an internal investigation, counsel should consider how much detail is required and be mindful of the multiple potential audiences who may someday review the report and related materials. Counsel should ensure that the content of the documents is as precise as possible and contains appropriate caveats. The final report should include both exculpatory and mitigating information, and should neither exaggerate the evidence nor minimize it, while clearly differentiating opinion from fact. Interpretations, judgments, and sweep-

ing pronouncements should be avoided, particularly when summarizing employee interviews. Recognize that an employee who is accused of wrongdoing in such a report may bring a defamation action. This should not deter counsel from drawing conclusions that are supported by the facts, but consideration should be given to the weight of the evidence collected before specific allegations are made.

10. Retaining Drafts and Notes from Internal Investigation

In view of the passage of what some have coined the “Anti-Shredding Provision” of the Sarbanes-Oxley Act (15 U.S.C. § 1519), counsel should think carefully before destroying any drafts or notes generated during the internal investigation. The new statute prohibits the alteration or destruction of documents in relation to or contemplation of any government investigation. While in the past, attorneys may have sometimes destroyed drafts and notes once final interview summaries and reports were prepared, this may no longer be advisable. It may be possible to avoid drafts entirely if the report of internal investigation exists only in a single electronic file that is modified and supplemented as needed and as the investigation evolves. While it likely will be necessary to make notes at various times during the investigation, it would be wise to avoid having multiple people create notes of the same events or interviews. If possible, notes and other work product should be retained only by outside counsel.

11. Government Requests To Waive Privileges

a. Cooperating by Waiving Privilege

Recognize from the outset that the government may exert strong pressure on the company to “cooperate” by waiving its privileges, disclosing the results of its internal investigation, and possibly by producing the underlying work product to the government. The new Department of Justice guidance to prosecutors is that, while waiver of attorney-client and work product protections “is not a prerequisite to a finding that a company has cooperated,” in certain circumstances a company may be requested to waive the privilege and the company’s response “may be considered in determining whether a corporation has cooperated in the government’s investigation.”⁵⁵ The guidance does, however, impose certain limits.

⁵⁵ McNulty Memo, *supra* note 23, at 9.

Prosecutors may only request a waiver when a “legitimate need” exists, although this standard seems easily satisfied.⁵⁶

Assuming the standard is met, the prosecutor may initially only seek a waiver for “purely factual information,” such as copies of key documents, witness statements, purely factual interview memoranda, organization charts, factual chronologies, and summaries and reports containing investigative facts documented by counsel (collectively referred to as “Category I” information). Before seeking a waiver for the production of Category I information, the prosecutor must obtain written authorization from the United States Attorney, who, in turn, must consult with the Assistant Attorney General for the Criminal Division. If the request is authorized, the United States Attorney must communicate the request in writing to the company. A company’s failure to agree to waive the privilege as to Category I information may be considered in determining whether a company has cooperated with the government’s investigation.⁵⁷

In “rare circumstances,” if the Category I information provides an “incomplete basis to conduct a thorough investigation,” prosecutors may seek authorization to request a company to waive the privilege as to nonfactual work product such as legal advice given to the company, attorney notes, memoranda or reports (or portions thereof) containing counsel’s mental impressions and conclusions, and legal determinations reached as a result of an internal investigation (collectively referred to as “Category II” information). Before a company may be requested to produce Category II information, the United States Attorney must obtain written authorization from the Deputy Attorney General. If a company then chooses to decline to provide a waiver for Category II information, prosecutors must *not* consider this refusal in making a charging decision against the company.⁵⁸

It remains to be seen whether the recent change in the Department of Justice guidance will result, on an overall basis, in fewer requests to compa-

⁵⁶ The McNulty Memo sets out four considerations for the determination of legitimate need: (1) the likelihood and degree to which the privileged information will benefit the government’s investigation; (2) whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver; (3) the completeness of the voluntary disclosure already provided; and (4) the collateral consequences to a corporation of a waiver. *Id.* at 9.

⁵⁷ *Id.* at 8-9.

⁵⁸ *Id.* at 10.

nies to waive the privilege. Even if it does, no particular company will know at the outset of an internal investigation whether the prosecutor will or will not request a waiver in its case, and should assume that a waiver will be requested and given. Moreover, even if a waiver is not requested, a company may still feel pressure to voluntarily waive and turn over the results of an internal investigation, since a prosecutor may consider this in assessing the extent of the company's cooperation.⁵⁹

In the past, the SEC staff has indicated that the SEC takes a somewhat different approach from the Department of Justice and that companies should expect that the SEC *will* ask for the privilege to be waived, although the SEC typically will only request after-the-fact investigative reports and not the legal advice that companies receive concerning the investigation.⁶⁰

SROs likely will seek these reports as well, as they increasingly are adopting policies and procedures that in many cases mirror those of the SEC and Department of Justice in response to pressure to police the conduct of their members. For example, in September 2005, the NYSE issued an "Information Memorandum" on "Cooperation" in which it explained that an entity may get credit for "extraordinary cooperation" where the entity waives its privileges and produces employee interview notes and reports of internal investigations.⁶¹ It is not yet known whether the SEC and SROs will modify their current practices and policies in light of the newly announced Department of Justice guidance.

To the extent that any criminal charges are brought against a company, the *Federal Sentencing Guidelines* no longer contain language indicating that

⁵⁹ Not satisfied with the changes announced in the McNulty memo, Senator Arlen Specter reintroduced legislation on January 4, 2007, that, if enacted, would prohibit the Department of Justice from requesting or demanding disclosure of a communication protected by the attorney client privilege or any attorney work product. Nonetheless, even this legislation would allow the government to accept a voluntary and unsolicited offer to waive the privilege and share the results of an internal investigation. Attorney Client Privilege Protection Act, S. 186, 110th Cong. § 3(a) (2007).

⁶⁰ Remarks of Linda Chatman Thomsen, Director of the SEC's Division of Enforcement, as reported by Tim Reason, *The Limits of Mercy*, CFO.com (May 2005), available at <<https://www.cpa2biz.com/News/Selected+Features/The+Limits+of+Mercy.htm>> (last visited Dec. 15, 2005), and at the 37th Annual PLI Securities Institute (Nov. 5, 2006). See also the Seaboard Report, *supra* note 22 ("Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review?").

⁶¹ See NYSE Information Memorandum No. 05-65 (Sept. 14, 2005).

companies that surrender otherwise privileged materials to government investigators will be rewarded.⁶² However, the Department of Justice guidance still states that, in plea agreements in which the corporation agrees to cooperate, prosecutors "may request that the corporation waive attorney-client and work product protection, make employees and agents available for debriefing, and disclose the results of internal investigation," among other requests.⁶³

b. Alternative To Turning Over Report of Internal Investigation

If it becomes necessary to make a disclosure to the government, consider suggesting an alternative approach to turning over the report of the internal investigation. In prepared remarks to a Sentencing Commission working group, a representative of the Department of Justice suggested that the Department may be receptive to an offer of voluntary disclosure by direct access to witnesses rather than to internal summaries and analyses of witness statements.⁶⁴ Another possible approach is to offer an oral presentation of the results of an internal investigation. While there still is a risk of subject-matter waiver with this approach, the company will have a better chance of maintaining the privilege than if documents are provided. Keep in mind that, even if the government agrees to a limited disclosure, a private civil litigant will likely argue that the company's disclosure was a broad waiver as to *all* materials relating to the same subject matter, even if those materials were not all furnished to the government.

⁶² Effective November 1, 2006, the Sentencing Commission struck the following language from Application Note 12 of the Commentary to section 8C2.5: "Waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score . . . unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization." The Commission indicated that it deleted this sentence because it had received public comment and heard testimony at public hearings that this sentence "could be misinterpreted to encourage waivers." See FEDERAL SENTENCING GUIDELINES SUPPLEMENT TO APPENDIX C - AMENDMENTS TO THE GUIDELINES MANUAL No. 695, 179 (Nov. 1, 2006), available at <<http://www.ussc.gov/2006guid/APPC2006.pdf>> (last visited Jan. 2, 2007).

⁶³ See McNulty Memo, *supra* note 23, at 19.

⁶⁴ Gregory J. Wallace, *Holder Memorandum Revisited: DOJ Offers Clarification of Corporate Waiver*, LJM BUS. CRIMES BULL., vol. 9, no. 12 (Jan. 2003).

c. Nonwaiver Agreement

If the report and other materials must be produced, the company should seek a “confidentiality” or “nonwaiver” agreement from the government.⁶⁵ Nonetheless, even with such an agreement, a court may well find that a waiver has occurred, at least as to the produced materials.⁶⁶ As a result of these legal decisions, a new Federal Rule of Evidence has been proposed that, if enacted by Congress, would allow a corporation to make a selective waiver of the privilege in order to produce privileged material to the government without waiving the privilege for those materials as to third parties.⁶⁷ Such a rule already has been enacted in the context of submis-

sions to federal banking agencies.⁶⁸ Absent such a provision, counsel may wish to negotiate with the government for disclosure to occur after or simultaneously with any settlement or other resolution so that a stronger case may be made that the disclosure was part of confidential settlement discussions and/or that the company and government are not adversaries and the disclosure was made as part of a common interest in fully investigating the alleged wrongdoing, and, so, no waiver occurred.⁶⁹

⁶⁵ The SEC has said that it has a policy of entering into confidentiality agreements where it determines that receiving information from a company pursuant to such an agreement will further the public interest, and that it will “vigorously argue in defense of those confidentiality agreements where litigants argue that the disclosure of information pursuant to such agreements waives any privilege or protection.” See Implementation of Standards of Professional Conduct for Attorneys, SEC Release Nos. 33-8185, 34-47276 (Jan. 29, 2003). A nonwaiver agreement may say something like:

Please be advised that, by agreeing to produce and/or producing the confidential materials, the company has not waived and does not intend to waive, the attorney-client privilege, attorney work product protection or any other applicable protection as to any third party. The Securities and Exchange Commission staff will not assert that the company’s voluntary communication of the confidential materials to the staff constitutes a waiver of such privileges or protections as to any third party. The Securities and Exchange Commission staff will maintain the confidentiality of the information produced by the company pursuant to this agreement and will not disclose it to any third party, except to the extent that the staff determines that disclosure is otherwise required by law or would be in furtherance of the staff’s discharge of its duties and responsibilities.

⁶⁶ See e.g., *In re Qwest Commc’ns Int’l Inc.*, Sec. Litig., 450 F.3d 1179, 1192-1201 (10th Cir. 2006 and cases cited therein) (joining the First, Second, Third, Fourth, Sixth and D.C. Circuits in rejecting the theory of selective waiver). Cf. *Diversified Indus. v. Meredith*, 572 F.2d 596, 607 (8th Cir. 1977) (en banc) (only a limited waiver of attorney-client privilege occurred from voluntary surrender of material to the SEC); *In re M&L Business Machine Co.*, 161 B.R. 689, 691 (D. Colo. 1993) (court applied selective waiver to attorney-client privilege where disclosures were protected by a confidentiality agreement); *In re Martin Marietta Corp.*, 856 F.2d 619, 623-24 (4th Cir. 1988) (selective waiver applied in relation to opinion work product). The Sixth Circuit has said the law is in a state of “hopeless confusion.” *In re Columbia/HCA Healthcare Corp. Billing Practices*, 293 F.3d 289, 294-95 (6th Cir. 2002).

⁶⁷ See Proposed Rule of Rule of Evidence 502(c), available at <<http://www.uscourts.gov/rules/Reports/EV05-2006.pdf>> (last visited Jan. 2, 2007):

In a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection—when made to a federal public office or agency in the exercise of its regulatory, investigative, or enforcement authority—does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities. The effect of disclosure to a state or local government agency, with respect to non-governmental persons or entities, is governed by applicable state law. Nothing in this rule limits or expands the author-

ity of a government agency to disclose communications or information to other government agencies or as otherwise authorized or required by law.

⁶⁸ See Section 607 of the Financial Services Regulatory Relief Act of 2006, which amended Section 18 of the Federal Deposit Insurance Act (12 U.S.C. § 1828) to provide the following:

The submission by any person of any information to any Federal banking agency, State bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process of such agency, supervisor or authority shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to information under Federal or State law as to any person or entity other than such agency, supervisor, or authority.

Similar language was added to the end of Section 205 of the Federal Credit Union Act (12 U.S.C. § 1785). This became Public Law No. 109-351.

⁶⁹ The agreement with the government could be drafted to include language reflecting this common interest and nonwaiver, although there certainly would still be a risk that a court would find a waiver of the privilege. Such language might say something like:

The parties agree that the corporation and the U.S. Attorney’s Office share a common interest in determining all the facts relating to the matters under continued investigation and in reaching a proper resolution of all related issues. The office agrees to use the information and documents produced by the corporation pursuant to this agreement solely for the purposes of its continuing criminal investigation and that it will give such information and documents equivalent secrecy protection as it would give Fed. R. Crim. P. 6(e) grand jury materials and material covered by law enforcement and informant’s privileges. The parties therefore agree that the corporation has not waived the attorney-client or work product privilege by virtue of cooperation pursuant to this agreement.

PART II:

ISSUES AND ACTIONS TO CONSIDER WHEN THE GOVERNMENT EXECUTES A SEARCH WARRANT

When the government seeks company records through issuance of a search warrant rather than a subpoena, this means the government has presented specific information to a judge or magistrate (usually by affidavit) showing probable cause to believe that a crime was committed and that evidence of the crime exists on the company's premises. The government's decision to obtain records by search warrant rather than subpoena may well mean that the government believes records have been destroyed or are in danger of being destroyed in order to conceal evidence of wrongdoing.

Large companies often have a corporate response plan in place that specifies what should be done, and by whom, in the event that a search warrant is ever executed. This is a wise practice, as there is little time to react when government agents suddenly descend on an office or plant and begin rummaging through drawers and computers and walking away with boxes of documents and mirror images of computer hard drives.

While it is important not to interfere with the search, it is equally important to ensure that the government agents do not exceed the scope of the warrant and that the disruption to the business is minimized. If at all possible, the company should get an experienced criminal attorney at the search site immediately, or at the very least speak with one by telephone. The following is a list of additional immediate actions to consider.

A. Make Contact with the Search Site

In whatever way possible, make contact with the employee in charge at the search site ("the company representative"). If no one is in charge, designate someone. Obtain a phone number for the company representative and request that the line be kept open. Often a mobile phone works best, since the representative may need to move around during the search.

B. Consent

Consider telling the company representative not to consent to the search, or to withdraw consent if it already has been given. If the company elects to consent to the search, it will be difficult to later challenge the warrant and attempt to suppress evidence that may be obtained during the search.

C. Examine the Warrant

Agents executing a search warrant are generally required to provide a copy of the warrant to the company.⁷⁰ Have the warrant faxed to counsel as soon as possible so it can be examined. Counsel should make sure that the warrant identifies (a) the issuing magistrate; (b) a description of the place to be searched and items to be seized; (c) whether the warrant is being executed within the allowable time (usually within 10 days from when it was issued, and it must be served between 6 a.m. and 10 p.m., unless it specifies other hours). If the warrant does not authorize the search, immediately bring this to the attention of the agent who is in charge and request that the search be terminated.

D. Speak to and Collect Information from the Government Agents

Counsel for the company should speak with the government agent who is in charge of the search ("the agent-in-charge"). If the agent-in-charge declines to take the phone call, the company representative at the site should speak with that agent.

- The agent should be informed that the company will do everything possible to make sure that the search proceeds smoothly but that the company requests that the agents refrain from starting (or continuing) the search until the company's counsel arrives at the site and can ensure that the warrant is valid and that privileged documents are segregated. Most likely, the agent-in-charge will decline this request.
- Consider requesting that all questions be directed to the company's attorney and that employees not be questioned outside the presence of

⁷⁰ See FED. R. CRIM. P. 41(f)(1)(B).

counsel. Again, the agent-in-charge may well ignore this request and attempt to question employees during the search.

- Ask for a business card for the agent-in-charge (or at least get his or her name, agency, and phone number). If possible, get cards for the other agents as well or ask that they sign in at the desk if this is a normal procedure for guests. Also ask for the name and phone number of the prosecutor assigned to the case. Ask for a copy of the affidavit in support of the search warrant. This need not be provided and may even be sealed, but will provide a wealth of information if the agent has the affidavit and chooses to turn it over.
- The company should try to get as much information as possible from the agents about the reason for the search, but realistically will get little. At a minimum, counsel should attempt to learn what agencies are represented during the search, since this may reveal the subject of the investigation, as well as whether multiple agencies (e.g., FBI and IRS) are involved in the investigation. Of course, counsel should inquire about the conduct being investigated and whether the company or any of its employees are subjects or targets of the investigation.
- If the agent-in-charge has not yet provided a copy of the warrant to the company, a copy should be requested. The agent-in-charge should also be requested to segregate those materials that were seized before the warrant was served.
- To the extent that the company has suggestions for ways to minimize the disruption from the search, these should be discussed with the agent-in-charge. If appropriate, the company may suggest sealing off the area of the search so other personnel do not enter during the search. If it is essential that certain employees remain on the job and not be disrupted from their work, ask whether the search of their work area can be completed first.

E. Send Employees Home and Advise Them of Their Rights

Employees should be informed that they should cooperate with the search and not do anything to interfere with it. At the same time, employees may be informed of their rights: they are under no obligation to answer ques-

tions on the spot, create, or sign any documents, and may, if they choose, consult with an attorney before answering questions and have an attorney present during questioning. The employees should be told that the decision of what to do is entirely up to them.

To the extent possible, employees should be sent home for the day unless business needs require that they remain. The government agents likely will attempt to conduct on-the-spot interviews of employees despite the request that this not be done without the presence of counsel and despite the resulting disruption to the business.

If employees are sent home, consider giving them the name and phone number of the company's attorney before they leave (it may be necessary later to identify alternative counsel if there are potential conflicts). It is best to give the employees a cell phone number for the attorney in the event the government contacts them at home outside of normal business hours.

Employees should be requested not to discuss the search with other employees unless the company's attorney is present. They should also be advised to refer any media inquiries to the company's designated spokesperson. As always, counsel must be careful not to say anything that the government might perceive as an effort to impede the investigation.

F. Monitor the Search

If necessary, the company representative should identify a handful of employees to remain during the search to assist in monitoring and keeping a record of the details of the search. This record should be kept at the direction of, and furnished to, the company's counsel so that the privilege attaching to it remains intact. Without interfering with the search, these employees should attempt to make a record of the name of the agent being monitored, his or her agency, where the agent is searching (be as specific as possible), the beginning and ending time for the search of each location, and what the agent removed. If agents are copying computer files, the agents should be asked what files they are copying, or the person monitoring the agents should observe the process and record this. To the extent that the agents are searching in places not identified in the warrant, the agents should be notified of this and told that the company objects to any search of the locations not identified in the warrant.

G. Protect Privileged Documents

If there are privileged documents at the search site, the agent-in-charge should be informed of this and told of the specific locations where the privileged documents are kept. The agent should be advised that the company does not waive the attorney-client privilege and other privileges. The company should request the agent to segregate these documents and not review them. Depending upon the number of documents involved, it may be difficult to review documents for privilege until later. If so, the company may want to suggest sealing these documents until they have been reviewed.

If privileged material exists on computer files that the government has seized, counsel will have to negotiate with the government about the segregation and review of such files to ensure that privileged documents are protected. One approach is to request the government to make two copies of seized computer data so one copy may be sealed and turned over to the magistrate or special master and the other copy may be reviewed by counsel for the company.

H. Documents Needed To Operate the Business

If the government is removing documents that are critical for the operation of the business, these should be identified and the company should ask to make copies of the documents before they are removed. If the critical materials are voluminous, ask to have a copy service make copies as soon as possible.

I. Alert the Company's Media Spokesperson

As soon as possible during or after the search, counsel should contact the company's public affairs spokesperson about the search so that the spokesperson can prepare for possible inquiries from the press. A statement should be prepared in the event that the press learns of the search.

J. Inventory List of Seized Materials

An agent present during the search must prepare and then verify an inventory of any property seized and must do this in the presence of another agent as well as in the presence of a company representative. The agent also must provide a receipt for the property taken. After the search, the agent must return the inventory list to the magistrate judge who issued the warrant. Upon request, the magistrate judge must provide a copy to the company.⁷¹

K. Post-Search Inventory and Debriefing

After the agents have left, the company should identify the areas that were searched and the employees who work in those areas. Those employees should go through the area and identify what was seized. Employees should be interviewed about these documents and debriefed concerning any questions that were posed to them during the search and any answers that they gave. Suggested practices for employee interviews that were discussed previously in this monograph apply here as well.

L. Review Checklist of Issues To Consider in Light of Government Investigation

Now that the company is on notice of a government investigation, counsel should consider the numerous of issues that were identified in Part I of this monograph.

⁷¹ See FED. R. CRIM. P. 41(f)(2), (3)(B), (4).

CONCLUSION

Although this monograph has identified a large number of issues to contemplate in the event of a government investigation, additional issues undoubtedly will surface. These may stem from the unique nature of a particular corporate situation or investigation, or from new developments in the law. In grappling with these myriad and thorny issues, counsel must be ever mindful of both the short-term and long-term consequences of any decision that is made, not only with respect to the investigation at hand but potential follow-on litigation. Given the complexity of the issues and the risks for the company, counsel is well advised to seek out a specialist in government investigations at the earliest opportunity.

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