603:Globalized Risk: Internal Investigations outside the U.S.

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Prior to joining Morrison & Foerster, Mr. Loewenson served as an assistant United States attorney in the Southern District of New York. Mr. Loewenson served on the Securities and Commodities Fraud Task Force, where he prosecuted cases involving insider trading, stock manipulation, other securities fraud offenses, and tax evasion. In 1991, he received the Director's Award for Superior Performance from the director of the executive office for United States attorneys.

He received his BA from the Woodrow Wilson School of Public and International Affairs at Princeton University and his JD from Yale Law School, and was a Fulbright Scholar.

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David L. Stulb is the national leader of the fraud and investigations team within Ernst & Young's Investigative & Dispute Services practice. Mr. Stulb has extensive experience in the case management of complex "white collar" and "corporate internal" investigations, Foreign Corrupt Practices Act due diligence and investigations, money laundering compliance issues, and other litigation and investigative matters in both national and international venues. He has been named as an expert on matters pertaining to securities fraud, international business disputes, and financial service regulatory compliance issues by major law firms and their clients. His practice incorporates coordination of investigative findings and interaction with the SEC, Justice Department, FBI, FDIC, FinCen reps, and other international regulatory agencies. He has had extensive experience in bankruptcy and reorganization consulting engagements involving matters that require investigative and regulatory expertise.

Prior to admission to Ernst & Young, Mr. Stulb was, among other positions, the global partner-in-charge of the business fraud and investigation services for Andersen LLP, assistant vice president risk management for Cartier, Inc., operations officer with the CIA, and a former Marine Corps officer.

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Ethics of Internal Investigations After Enron

Presented by Carl H. Loewenson, Jr.

I. ETHICS OF INTERNAL INVESTIGATIONS

A. The organization as client

1. A basic fact of any representation of a corporate client is obvious on paper but can be tough in reality: the organization itself is the client. The executives and officers, board members, shareholders and other stakeholders are part of the corporation, but they do not embody it. Attorneys must be careful to recognize and remember this fact, and to explain it to constituents of the corporate client.

2. See ABA Model Rule 1.13 ("Organization as a Client"), New York Disciplinary Rule 5-109 [22 NYCRR § 1200.28]: ("Organization as Client").

a. ABA Model Rule 1.13(d) requires a lawyer, in dealing with an organization's directors, officers, employees, members, shareholders or other constituents, to 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.

b. New York Disciplinary Rule 5-109(a) requires a lawyer retained by an organization to explain to officers, directors, employees, members, shareholders, or other constituents of the organization that the attorney represents the corporation, not any of the constituents.

i. This is critical when conducting interviews of directors, officers, or employees in an internal investigation.

ii. Dual representation (of an entity plus individual(s)) in an internal investigation is risky and generally a bad idea.

c. ABA Model Rule 1.13 (b) and New York Disciplinary Rule 5-109(b) lay out the circumstances under which an attorney must proceed in the best interest of the corporation, as opposed to the best interest of an individual constituent of the organization. This is the closest that the rules come to a "whistleblower" provision for in-house counsel. Two threshold conditions must exist:

i. the attorney knows that an officer, employee, or other person associated with the organization is engaged in an action that is either:

(a) illegal (i.e., a violation of the securities laws), or

(b) a violation of a legal obligation to the organization (such as a breach of fiduciary duty, for example, an usurpation of a corporate opportunity); and

ii. this action is likely to result in substantial injury to the organization.

d. The general guidance is not all that helpful: in such situations, the lawyer "shall proceed as is reasonably necessary in the best interest of the organization."

e. ABA Model Rule 1.13 (b) [New York Disciplinary Rule 5-109(b)] does give some additional guidance, stating that in determining how to proceed, a lawyer may consider the following factors:

i. the seriousness of the violation and its consequences;

ii. the scope and nature of the lawyer's representation;

iii. the responsibility in the organization and the apparent motivation of the person involved;

iv. the policies of the organization concerning such matters; and

v. any other relevant considerations.

f. The rule – far from favoring disclosure to authorities – limits disclosure outside the organization. Under ABA Model Rule 1.13 (b) [New York Disciplinary Rule 5-109(b)], the lawyer must take measures designed to minimize disruption to the organization and the risk of revealing information relating to the representation to persons outside the organization. ABA Model Rule 1.13 (b) suggests the following measures:

i. asking reconsideration of the matter;

ii. advising that a separate legal opinion on the matter be sought for presentation to the appropriate authority in the organization; and

iii. referring the matter to a higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law (usually the board).

g. ABA Model Rule 1.13 (c) [New York Disciplinary Rule 5-109(c)] permits an attorney to resign if, despite the lawyer's efforts in accordance with the rule generally, the highest authority that can act on behalf of the organization insists upon an action, or a refusal to act, that is clearly a violation of law and is likely to result in a substantial injury to the organization.

B. Defining the scope of the investigation

1. Recent events have highlighted the importance of conducting thorough and independent internal investigations.

a. At the Arthur Andersen federal criminal trial in Houston, the now-(in)famous Vinson & Elkins report on the Sherron Watkins allegations at Enron was termed a "whitewash."

b. Coudert Bros., as part of its independent investigation of accounting issues at Global Crossing, found that the manner in which Simpson, Thatcher & Bartlett conducted its internal investigation of the company breached its professional obligations to the company.

c. Numerous companies engaged in the now all-too-familiar audit committee investigation as part of an accounting restatement have had to redo internal investigations because of insufficient independence, scope, or rigor.

2. In conducting internal corporate investigations, lawyers generally have two goals – to uncover the facts and to advise management regarding the corporation's potential liability.

3. Knowledge of all the facts will allow the corporation to develop an appropriate response to possible charges of wrongdoing. The corporation may then anticipate and argue against prosecution, avoid being blindsided by unknown facts, and correct any past errors. The investigation itself may also be seen as a positive indication of the responsible conduct of the

corporation. Early action by a corporation once it believes a problem may exist will contribute to an effective defense against the allegations of corporate wrongdoing.

4. Vinson & Elkins, Enron's longtime outside counsel, were asked to investigate allegations of wrongdoing – but they were also told not to second-guess the accountants. Was the scope of the investigation too limited?

   a. In the memo that spurred the investigation, Sherron Watkins suggested that the accountants were not making appropriate judgments. She raised the possibility of ethical and criminal violations. It was the general counsel's responsibility and obligation to make sure those claims were thoroughly investigated.

   b. Ms. Watkins suggested two steps to follow up on her memo: hiring independent counsel to conduct a widespread investigation, and hiring independent auditors to analyze transactions and opine on the auditing treatment employed by Enron and Arthur Andersen. The general counsel of Enron and a Vinson & Elkins partner reviewed her suggestions and concluded (1) that Vinson & Elkins was sufficiently independent and could adequately perform the investigation, and (2) that the hiring of independent auditors was unnecessary at the time. Both of these decisions have since been called into question, to put it mildly.

      i. Vinson & Elkins' report concluded that there were "bad cosmetics" and "a serious risk of adverse publicity and litigation," but said that further investigation was not warranted.

      ii. Seven weeks after the report was submitted to Enron, Enron filed the largest bankruptcy in U.S. history. Vinson & Elkins has been named in class action lawsuits filed on behalf of Enron shareholders and employees.

      iii. Vinson & Elkins' motion to dismiss was denied, because the district court found that the complaint adequately alleged that Vinson & Elkins had actively participated in fraud. *In re Enron Corporation Securities, Derivative and ERISA Litigation, Memorandum and Order Re Secondary Actors' Motions to Dismiss*, No. H-01-3624, MDL-1446 (S.D. Tex. Dec. 20, 2002).

      iv. They have also suffered adverse publicity and been dragged before Congress.

c. There were valid, rational reasons for the decisions made by Enron and Vinson & Elkins.

i. Lawyers accept limitations on the scope of their work all the time. They are not experts in all matters, and they often assume the accuracy of an outside expert's conclusion.

ii. A corporation cannot do a full-blown, civil discovery-type internal investigation every time it receives an allegation of wrongdoing.

iii. Sometimes speed is of the essence. It can be very important to get to the bottom of an allegation very quickly. Reviewing auditing judgements would have added a significant amount of time to the investigation and delayed the conclusion of the investigation.

(a) *See John H. Gutfreund*, Exchange Act Release No. 34-31554, 51 S.E.C. 93 (Dec. 3, 1992) (Salomon Bros. criticized for taking too long with its internal investigation of the Treasury trading scandal).

d. Nevertheless, in this case these decisions turned out very badly, both for the company and for the firm. In light of recent events, attorneys should take steps to protect themselves and their clients in performing independent investigations.

e. Everyone – shareholders, the board of directors, outside auditors, prosecutors, the Securities and Exchange Commission, Congress – will expect post-Enron internal investigations to be independent, thorough, and robust.

5. How to avoid this quandary?

a. Seek authority sufficient to conduct a credible and competent investigation of the issue troubling the organization.

b. Ideally, the engagement letter will make explicit that the investigation has an unlimited scope, including but not limited to the specific issues that gave rise to the need to investigate. The investigators will of course have to apply the usual investigative filters to prevent an endless inquiry without focus.

c. Lawyers should be careful not to accept limits that prevent them from performing the investigation thoroughly and competently.

C. "Up the Ladder" reporting requirements: Implementing § 307 of Sarbanes-Oxley

1. Attorneys appearing and practicing before the Commission in representation of an issuer must report evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer. Unless the issuer has established a Qualified Legal Compliance Committee ("QLCC"), the attorney must make the report to the Chief Legal Officer of the issuer (the "CLO") or to both the CLO and the CEO. *See* Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 CFR § 205.1 et seq.

2. The SEC's attorney conduct rules broadly define a "material violation" to include "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or similar material violation of any material United States federal or state law." 17 CFR § 205.2(i).

3. "Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." 17 CFR § 205.2(e). Commentators and practitioners have noted the difficulty of converting into practice the double negative ("it would be unreasonable . . . not to conclude") in this key provision of the rule.

4. If the attorney does not receive a timely and appropriate response from the CLO after reporting evidence of a material violation, the attorney is required to report the evidence of the material violation "up the ladder" to (a) the issuer's audit committee or, in the absence of an audit committee, (b) to another committee of the board of directors consisting solely of independent directors or, in the absence of such a committee, (c) the full board of directors. 17 CFR § 205.3(b).

5. An "appropriate response" is defined as an issuer's response to an attorney which causes the attorney to reasonably believe that:

   a. no material violation has occurred, is occurring or is about to occur,

   b. the issuer has adopted appropriate remedial measures or sanctions to stop, prevent or address any past, present or future material violation and minimize the likelihood or its recurrence, or

   c. the issuer, with the consent of the board of directors, authorized board committee or QLCC, has retained or directed an attorney to

investigate the matter and the issuer (a) has implemented any remedial measures recommended by the investigating attorney or (b) has been advised by the investigating attorney that a "colorable defense" can be asserted on behalf of the issuer or its affiliates in connection with the material violation. 17 CFR § 205.2(b).

6. Who is covered by the Rule?

   a. The Rule broadly defines "appearing and practicing" before the SEC and covers attorneys who communicate in any way with the SEC on behalf of an issuer, including: representing an issuer in a SEC enforcement proceeding, investigation or inquiry; being involved in the preparation of any statement, opinion or other writing incorporated in materials filed or submitted to the SEC; advising a client on the submission of SEC filings or registrations.

   b. Many, but not all, foreign attorneys are excluded from the Rule's coverage. The Rule does not apply to "non-appearing foreign attorneys", who are defined as attorneys:

      i. who are not licensed to practice law in the US,

      ii. who do not hold themselves out as practicing or giving advice on U.S. law, and

      iii. who conduct activities that would constitute appearing and practicing before the SEC only incidentally to his or her foreign practice or appear or practice before the SEC only in consultation with U.S. counsel. 17 CFR § 205.2(j).

7. If the lawyer has uncovered planned future wrongdoing, what should the attorney do?

   a. Under no circumstances may the lawyer assist in the illegal conduct.

   b. The in-house counsel should not reveal past wrongdoing to persons outside the company, absent an exception to the confidentiality rules.

      i. Again, under no circumstances should a lawyer participate in illegal conduct. The appropriate course of action is to withdraw from representation, or in the case of in-house counsel, leave the company or obtain a transfer to different job responsibilities.

ii. The ABA Model Rules do not recognize an exception to confidentiality for fraudulent activity. ABA Model Rule 1.6.

iii. New York Disciplinary Rule 4–101(c) states: "A lawyer *may* reveal … (3) The intention of a client to commit a crime and the information necessary to prevent the crime." [emphasis added] By no means is the lawyer *required* to do so.

c. Under the SEC's attorney conduct rules implementing Section 307 of Sarbanes-Oxley, the attorney must report the wrongdoing forthwith to either the chief legal officer of the issuer or to *both* the chief legal officer and the chief executive officer. 17 CFR § 205.3(b).

D. In-house versus outside counsel as investigators

1. In-house counsel have advantages:

a. In-house counsel are better acquainted with the company.

b. Employees may be more open in discussing sensitive matters if they know the investigator. Maybe not.

c. In-house counsel cost a lot less.

2. Other factors favor outside counsel conducting the investigation.

a. Outside counsel may provide a more objective analysis.

b. The judgment of outside counsel, who are experienced in similar cases, may be valuable to the corporation.

c. In-house counsel may not appear as independent or as credible to prosecutors as outside counsel.

d. The attorney-client privilege may be more easily maintained by outside counsel. In-house counsel are often required to provide business as well as legal advice, and to share information for matters under investigation with other corporate officers and employees, resulting in waiver of the privilege. The government may be more alert to the potential for waiver when in-house counsel conducts the investigation.

e. In-house counsel may be too close to many problems to see them.

f. By using outside counsel who work closely with in-house counsel, the corporation may take advantage of both the benefits of retaining outside counsel and the familiarity with a knowledge of the corporation by in-house counsel.

E. Independence of reporting lines

1. Investigations are typically supervised by independent directors—either the audit committee or a special litigation committee.

2. The client is the board committee.

3. Management is usually not included in the reporting line regarding progress of the investigation.

4. This is a thorny problem for non-U.S. corporations, many of which have strong management control and/or a supervisory board of outside directors without the authority that a U.S. audit committee possesses. *See* Section 301 of Sarbanes Oxley (giving audit committees the authority to hire their own counsel).

5. If a foreign corporation has a U.S. investigative problem – e.g., Royal Ahold, Vivendi, Royal Dutch/Shell, Parmalat, etc., etc. – it should adapt to U.S. expectations.

6. If a foreign issuer wishes to tap U.S. capital markets, such American "legal imperialism" will become a fact of life , like it or not.

F. Thoroughly investigating conflicts

1. Sometimes, a too-close relationship of outside counsel and the client removes many of the benefits of having outside counsel conduct an internal investigation. This is conventional wisdom after Enron and Global Crossing.

2. Global Crossing/ Simpson Thatcher & Bartlett

a. Global Crossing's acting general counsel, also an active Simpson Thatcher partner, responded to an employee whistleblower complaint by retaining the company's primary outside counsel, Simpson Thatcher, to conduct the investigation.

b. Coudert's report concluded that the general counsel's simultaneous service as Global Crossing's acting general counsel and as a Simpson Thatcher partner "compromised the Company's relationship with ST&B; led to misunderstandings; and ultimately gave rise to a conflict of interest upon the failure of ST&B to adequately investigate [the whistleblower's] allegations."

3. Enron / Vinson & Elkins

a. It is now accepted fact that Vinson & Elkins was not sufficiently independent from Enron to enable V&E to give independent advice. The firm was thoroughly familiar with the client and with the client's representatives in the transactions. But, in hindsight, its investigation was not independent or adequate.

4. Risks vs. benefits of retaining long-standing outside counsel for an internal investigation

a. Granted, an investigation that is conducted by an outside firm that has a long-standing relationship with the organization will likely be quicker and cheaper than one conducted by a comparable firm that is completely outside of the events being investigated.

b. However, in the cold clear light cast by the Enron and Global Crossing debacles, and given the imperatives of the DOJ's "Thompson Memo" and the SEC's *Seaboard* decision, it is in the interest of both the firm and the organization to consider fully the ethical rules and to proceed cautiously if the investigation includes matters on which the firm has provided legal advice.

c. Post-Enron, everyone will expect that the firm that was involved in the underlying conduct is <u>not</u> the appropriate firm to do an internal investigation.

d. Similarly, the company's usual auditors are <u>not</u> the right firm to do the forensic accounting investigation.

5. Before conducting an investigation, an outside firm must decide if its prior legal work for the organization may be of such concern during the investigation as to materially interfere with the firm's judgment.

a. ABA Model Rule 1.7: ("Conflict of Interest: Current Client") states: A concurrent conflict of interest exists if:… there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of

the lawyer. Notwithstanding the existence of a concurrent conflict of interest … a lawyer may represent a client if: (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing.

b. NY Disciplinary Rule 5-101 [22 NYCRR § 1200.20], Conflicts of Interest – Lawyer's Own Interests, states: "A lawyer shall not accept or continue employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests, unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby and the client consents to the representation after full disclosure of the implications of the lawyer's interest."

c. In light of the circumstances giving rise to the investigation, a firm must (1) second-guess its own work and (2) notify the client of the potential conflict. This can be problematic, because a client may interpret notice of a possible conflict of interest as an assertion that the firm's prior work was flawed.

d. While it is hard to do, the ethical rules do require such second-guessing of one's partners and associates. Even if the firm initially concludes that a conflict does not exist, the client should be alerted to the possibility of one and give its consent to the firm performing or continuing the investigation.

e. The firm must continuously reevaluate its own limitations and biases as the investigation proceeds. If facts are discovered that imply that the judgment of an attorney may be materially affected, the ethical rules require termination of the representation.

f. If the investigation leads to a significant number of interviews of law firm partners and employees or substantial issues regarding law firm work product, other counsel should be retained to complete the investigation.

6. Warning signals. In the June 2002 issue of The New York Professional Responsibility Report, Prof. Mary Daly of Fordham Law School listed several "red flags" of internal corporate problems that may affect attorneys.

a. Beware of constituents whose decisions are "off limits." This may be difficult for clients to accept, as the autonomy of "off-limits" parties often corresponds to their importance to the organization's well being.

b. Watch out for the ABC's.

c. "A" is for corporate Abundance. Ethical concerns are not high on anyone's list when the company is making money, bonuses for employees are large, and law firm fees are being paid. "Creative" solutions to new problems, like special purpose entities or aggressive marketing of aggressive tax shelters, may become a little too imaginative. Board members may relax their oversight at a time when they are profiting from the exercise of stock options. Clients are more likely to shift numbers to hide an evaporation of abundance. Beware the big revenue producer who expresses annoyance with the geeks in the compliance department.

d. "B" is for Boosterism. Daly pointed out that many of the corporations that are visited by scandal are ones that had previously presented themselves as proud of their financial prowess and good corporate citizenship. They were praised in magazines and gave generously to local charities and fine arts organizations. The surface of their corporate citizenship was highly polished. The danger of boosterism is the danger of believing in one's own myth. The organizations may begin to believe in their infallibility and to lose a sense of responsibility to the rules imposed by ordinary mortals (and governments and laws). Boosterism also discourages dissent by employees, lawyers, accountants, and the media.

e. "C" is for a Culture of excessive Corporate Closeness. To properly perform their gatekeeper function, lawyers (like auditors) must keep an adequate degree of distance from their corporate clients. Law firms should carefully monitor the percentage of their income that is attributable to a major client: too great a dependence will make it hard to give advice the client does not want to hear, and even harder to walk away if faced with a decision concerning withdrawal.

f. Daly also cautions against compromising personal or relational ties, such as regular hiring of attorneys in the general counsel department from the ranks of a particular law firm.

7. Multiple Representations: Corporations and Corporate Constituents

a. Lawyers are sometimes called on simultaneously to represent both a corporation and one or more of its officers, directors, employees or other constituents in the context of a governmental investigation.

b. The ABA Model Rules of Professional Conduct allow a lawyer representing a corporation to represent any of its directors, officers, employees, members, shareholders or other constituents, subject to limitations (1.13 (e)).

i. According to the ABA Model Rules, in dual representations where two parties have no reasonable likelihood of becoming adverse, client consent is not needed. A lawyer may represent a constituent whose representation will be directly adverse to the corporation or whose representation presents a significant risk that one or more clients will be materially limited by the lawyer's responsibility if: (i) the lawyer reasonably believes that s/he will be able to provide competent and diligent representation to each client; (ii) the representation is not prohibited by the law; (iii) the representation does not involve the assertion of a claim by one client against another client in the same litigation or other proceeding before a tribunal; and (iv) each affected client gives informed consent, confirmed in writing. (1.7)

(a) Informed consent requires that each affected client be aware of the relevant circumstances and the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client. (1.0 (e))

c. New York Disciplinary Rule 5-105(c) states that counsel for a corporation will be ethically permitted to undertake such a multiple representation, provided the representation satisfies the following requirements: (i) corporate counsel concludes that in the view of a disinterested lawyer, the representation would serve the interests of both the corporation and the constituent; and (ii) both clients give knowledgeable and informed consent, after full disclosure of potential conflicts that might arise.

G. Ensuring the firm has the requisite expertise

a. Lawyers have a duty to act competently for their clients. They may not agree to provide representation when they know that they

lack the knowledge to perform adequately the services that are needed. This rule is particularly important in highly regulated industries, such as banking, securities, nuclear power, or other highly technical fields.

b. Lawyers must also know when and how to seek help in dealing with highly regulated fields. The ability to retain and work with competent, disinterested experts is critical to ethical representation.

c. ABA Model Rule 1.1, Competence, holds: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation."

d. Disciplinary Rule 6-101 [22 NYCRR § 1200.30], Failing to Act Competently, holds: "(a) A lawyer shall not: (1) Handle a legal matter which the lawyer knows or should know that he or she is not competent to handle, without associating with a lawyer who is competent to handle it."

e. In a cross-border investigation, the need for ensuring competence will often call for local counsel, experts, and accountants, not to mention translators.

H. How should an in-house counsel react to a whistleblower letter like the Sherron Watkins letter that accuses a company of accounting fraud?

1. Be guided by the following factors:

a. the level of seriousness of the alleged wrong;

b. the level of detail and substantiality of the allegation; and

c. the background and credibility of the employee making the allegation.

d. but be careful about discounting too much the word of a complainer or crackpot. Some of the best and most famous whistleblowers have been real misfits.

2. Begin by talking with the whistleblower, if the person is identified.

3. It the charge is made anonymously but appears to be serious and significant, begin an informal inquiry.

a. Talk to people who may know what is going on.

b. Look at company materials and records that are relevant to the allegation.

4. Decide if you should continue looking into it, close the file, or hire outside counsel.

5. If the allegations seem serious and substantial, or are from someone at the level of seniority and authority of Ms. Watkins, show the letter to the inside auditor, the outside auditor, the CEO and the audit committee. It is important to let the facts of the allegations be known to the relevant parties, and to let them know that you are following up. This is true even if you initially think that the claims are not legitimate.

6. Remind the audit committee members that they have the authority to retain their own auditors and counsel. (Sarbanes-Oxley § 301)

7. Try to evaluate the claim before beginning an investigation. Balance the inquiry that must be made against the possible disruption to the operation of the company during an investigation (disruption from people being brought in to be interviewed, etc.).

8. Remember that the general counsel's primary duty is to make a reasonable inquiry to determine whether there is a credible basis for the allegation.

I. Interviewing employees

1. Interviews are best handled by at least two people. The second person should serve as note taker, and may serve as a witness at some later time.

2. Employees should be informed of the purpose of the interview. This includes:

a. the fact that the government is conducting an investigation (if such is the case);

b. the nature of the problem being investigated;

c. the fact that counsel has been retained to provide advice to the company; and

d. the fact that the interview is necessary for counsel to obtain the information needed to provide appropriate advice to the company.

3. The employees must be informed that the interviewer is counsel to the corporation, not to the employee, and that the privilege belongs to the corporation.

    a. The employee should be advised that the substance of the interview may be disclosed to company management, to the board, and to the government. Such disclosure may occur where the company has a statutory obligation to disclose or the company anticipates it will be making a voluntary disclosure to the government.

    b. DOJ Thompson Memo and SEC *Seaboard* decision place pressure on corporations to provide to the government the results of internal investigations.

4. Both ABA Model Rule of Professional Conduct 1.13(d) and New York Disciplinary Rule 5-109 [22 NYCRR § 1200.28] require lawyers to explain clearly whom they represent when the interests of the employee are or may become adverse to that of the company. If there is a conflict, the lawyer should advise employees that they may wish to obtain independent representation.

5. After the interview, counsel should memorialize the substance of the conversation in writing. This writing should include counsel's standard introductory opening and closing remarks to the employee, and should also include counsel's mental impressions to preserve work-product protection to the extent possible.

II. DOCUMENT RETENTION, DESTRUCTION AND PRODUCTION POLICIES

A. Protecting against obstruction charges

1. Clients should not need reminding about the risks.

    a. Martha Stewart

    b. Computer Associates

    c. Frank Quattrone

2. The bizarre *Andersen* verdict is of little precedential value.

    a. Arthur Andersen was convicted not for wholesale destruction of documents, as had been alleged in the indictment, but rather for

one in-house counsel's memo to an auditor requesting that he delete a phrase from a memo of advice to the client.

b. This is the type of advice that lawyers – in-house and outside – give to clients all day long.

3. Nonetheless, we have all seen the destruction of Arthur Andersen after revelations that they had engaged in large-scale document destruction efforts after the government had begun investigating possible misconduct at Enron. Thus, it is the fact of the indictment, not the verdict, that commands attention.

4. Similarly, Credit Suisse First Boston in-house counsel delayed notification to relevant employees about receipt of a federal grand jury subpoena, setting in motion events leading to prosecution of Quattrone for obstruction of justice.

5. Today, organizations must have "fail safe" provisions and procedures to ensure that document destruction is halted once administrative, congressional, or judicial proceedings are on the horizon – even if the organization has not received a subpoena.

6. Documents may not be destroyed after a "proceeding" is pending.

a. In 1956, Judge Edward Weinfeld held that the destruction of documents, when it was known that a governmental body intended to issue a subpoena for them, constituted obstruction of justice. *United States v. Solow*, 138 F. Supp. 812 (S.D.N.Y. 1956). This ruling underlays then-White House Counsel Leonard Garment's advice to President Richard Nixon that the Oval Office tapes should not be destroyed in advance of a subpoena being issued from the Senate Watergate Committee.

b. In 1998, then District Judge Barrington Parker, Jr., ruled that criminal obstruction of justice also extends to civil litigation, where one party had deliberately destroyed documents to avoid production to an adversary. *United States v. Lundwall*, 1 F. Supp. 2d 249 (S.D.N.Y. 1998) (Texaco race discrimination case). *See also Cresswell v. Sullivan & Cromwell*, 668 F. Supp. 166 (S.D.N.Y. 1987).

7. Sarbanes-Oxley sets the trigger point even earlier, covering destruction of documents "*in contemplation* of any . . . matter [within the jurisdiction of any federal department or agency]." 18 U.S.C. § 1519.

8. Under federal law it is a felony for anyone to corruptly influence or "endeavor to influence" the administration of justice. 18 U.S.C. §§ 1503, 1505, 1510, 1512, 1519.

    a. Sec. 1503 of Title 18 defines the administration of justice as a pending judicial proceeding, such as a grand jury investigation. Under this statute, endeavoring to influence the proceeding (for example, by destroying documents before they are subpoenaed) will subject the actor to criminal liability.

        i. Obstruction of justice is committed when employees who were aware of grand jury proceedings and feared documents would be subpoenaed destroyed those documents. *See U.S. v. Gravely*, 840 F.2d 1156 (4th Cir. 1988).

    b. Sec. 1505 of Title 18 essentially follows § 1503. It differs in that it applies to administrative and congressional proceedings, including investigative proceedings.

9. It is a class E felony in New York State for a person to tamper with physical evidence "[b]elieving that [the] evidence is about to be produced or used in an official proceeding or a prospective official proceeding." N.Y. Penal Law § 215.40(2).

    a. Some other states require that a person "know" that proceedings are pending or about to be initiated. See, e.g., Texas Penal Code Ann. § 37.09, www.capitol.state.tx.us/ statutes/pe/pe0003700.html (last visited June 24, 2002).

10. Policies must be designed to ensure that document destruction stops as soon as possible after the organization knows of a judicial, administrative, or congressional proceeding that could conceivably seek the organization's documents.

    a. 18 U.S.C. § 1519

    b. As in *Andersen*, hindsight will lead to harsh judgments.

11. The new, broader federal obstruction statute and the current environment require a two-step procedure.

    a. First, employees should be able to use a centralized procedure to sound the alarm immediately after any investigation or proceeding comes to their attention.

b. Second, there must be a means for the organization's counsel to quickly stop and prevent the destruction of any documents (paper or electronic) that could possibly be of interest to investigators.

12. The *Arthur Andersen* and *Quattrone* experience have significantly altered the calculus. The prudent company must now err on the side of retention, not destruction.

B. Lawyers must provide clear communications to their client's employees of (1) the document destruction policy in general, and (2) exceptions to the policy, such as when investigations or lawsuits are pending or threatened.

1. A world with computers, photocopiers, fax machines, and email is a world with a great deal of information distribution, both electronic and on paper. While a certain amount of record keeping is appropriate, companies can become overwhelmed by information if it is not culled. Document destruction is a normal, necessary, and entirely legal part of most organizations' operations.

2. In this post-Enron/Arthur Andersen age, document destruction policies must be clear and explicit. Organizations must have clear guidelines on what should be kept and what should be dumped, when document destruction is encouraged and when it is forbidden.

a. The document retention policy should be applied steadily and consistently. Avoid periods of laxity or increased enforcement. The latter will be viewed with suspicion by the authorities and by private civil litigation opponents.

b. The policy should be clear and unambiguous: One of Arthur Andersen's main problems was that a lot of people simply did not understand the firm's written document retention policy.

c. When direction was given, e.g., Nancy Temple's now-famous October 12, 2001 email, it was ambiguous and susceptible of multiple meanings.

d. Attorneys should assume that, when in fear of a potential investigation, employees will destroy documents unless specifically instructed to do otherwise. It is likely that many if not most employees (like Michael Odom of Andersen, who starred in the October 2001 video played at the *Andersen* criminal trial) believe that if documents have not yet been subpoenaed, they are free to destroy them. As noted above, this is not the case.

e. The second step noted above is critical: the organization's attorney, after learning of the investigation, must issue clear directions that all destruction of any records in any media that have any conceivable connection to the matter under investigation must immediately halt until further written notice from an appropriate official.

i. The communication should delineate clear categories of documents that must be preserved.

ii. The communication must also convey the serious consequences of failing to follow the document preservation instructions – both to the organization and to the career of the employee.

iii. You should not have to exaggerate in order to scare people into compliance; recent history is a brutal reminder.

f. The attorney must immediately act to secure and protect documents relevant to the proceeding.

g. Any employee who is unwilling to follow the direction to preserve documents, or who intentionally violates the order, must be immediately terminated from the company.

C. Preserve all documents that need preserving, including electronic media.

1. At least two people should participate in the retrieval of documents that must be preserved, in order to ensure the security of the documents. At least one of these people should be an attorney. Teams of two people can be used if the number of documents that must be retrieved and preserved is very large.

2. Documents should be maintained in a secure location.

3. Documents take many forms and exist in many locations. Consideration should be given to electronic files and hard drives, documents in off-site storage locations, and documents of foreign and domestic branches and subsidiaries.

4. The routine overwriting of backup media for electronic documents (particularly e-mail) should be suspended.

D. Document production and compliance with local laws

1. There are instances where compliance with a U.S. governmental investigation would result in a violation of the laws of another country. For instance, Article 47 of the Swiss Federal Law on Banks and Savings Banks prohibits the disclosure of secret information disclosed to someone in his capacity as an officer or employee of a bank and lists a fine and/or imprisonment as possible punishment for such an action.

2. Courts have demonstrated an increasing willingness to order disclosure of documents, even in violation of foreign law, where the importance of the material sought to the investigation or litigation can be clearly demonstrated. For instance, in *United States v. Davis*, 767 F.2d 1025, 1035 (2d Cir. 1985) the Court ordered the production of Cayman bank records when the government proved that the information contained therein was "essential" for a successful criminal prosecution.

   a. Conversely, courts have rejected requests to compel the production of documents thought by the court to be trivial or irrelevant to the proceedings. This was demonstrated in *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341, 346 (7th Cir. 1983), in which an IRS administrative summons for Greek bank accounts was not enforced because the amount of money in the foreign account was only $1,100.

   b. Courts have refused to enforce grand jury subpoenas for records protected by foreign secrecy laws where a good faith effort to comply is made. In *Societe Internationale v. Rogers*, 357 U.S. 197, 211-13 (1958), the Supreme Court concluded that the plaintiff's inability to comply was "fostered neither by its own conduct nor by circumstances within its control." The Court held that the plaintiff had made "good faith" efforts to comply with the court order and ruled that dismissal of the complaint was too harsh a sanction. *Id.*

   c. A party may show good faith effort at compliance in many ways, including seeking permission to make disclosure from the appropriate government agency in the affected foreign country. Even if permission is not granted, courts have looked favorably upon the effort, as evidenced by *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 563 F.2d 992. 998 (10th Cir. 1977), in which the party from whom documents were sought sent a lengthy formal request to Canadian authorities. The court concluded that as a result of this letter there was "no basis for a finding of lack of good faith." *Id.*

