



MARCH 27, 2006

Think Twice

The good, bad and ugly of corporate investigations.



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“Too much of a good thing,” Mae West used to say, “...is wonderful.” But that may not be so all of the time.

Corporate internal investigations to deal with possible (or actual) wrongdoing have become increasingly popular, indeed even fashionable. Chief executive officers and boards of directors now seem to order these investigations as a matter of course. And while a principal beneficiary of this trend is (happily) the legal profession, query whether there is only upside, or whether there are some negatives that need to be taken into account before reflexively going down this path. But before we get to the negatives, there are some significant positives to note.

The ‘Goods’ of Investigations

There are, in fact, numerous (and compelling) reasons for public companies to initiate internal investigations. They include:

- To ascertain facts and to make informed legal and business decisions. See *Upjohn v. U.S.*, 449 U.S. 383 (1981).
- To fulfill obligations or responsibilities and duties of care to the corporation. See *Smith v. Van Gorkom*, 488 A.2d 845 (Del. 1985).
- To avoid the risks (and worse) of doing nothing.
- To be able, if an investigation uncovers mistakes, wrongdoing or worse, to take corrective steps, both as to addressing past conduct, but also with respect to prophylactic action.
- To buy (hopefully) the company some degree of goodwill and/or leniency by self-reporting to governmental/regulatory agencies.
- To get ahead of the public relations curve.
- To shore up the company’s stock price.

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The ‘Bads’ of Investigations

At the same time investigations can provide all the foregoing benefits (and more), significant downsides also need to be understood—and not only by lawyers (in-house and outside) but also by their corporate clients. This is particularly true in the tsunami regulatory (post-Enron) environment in which public companies now do business.

• The “Silver Platter.” First and foremost, when an investigation is undertaken and completed the results thereof are not merely a device by which management or the board can fix things. Rather, the results of such investigations often constitute what some have called a “silver platter”—an explicit road map detailing where all the bad evidence and bad actors are. As part of the process of seeking the prosecutorial/regulatory goodwill referenced above, governmental agencies now routinely ask for (read “demand”) that companies turn over any and all reports made to management or the board, as well as underlying attorney work product. The former “demand” is bad enough; it represents an acceleration in the evisceration of the attorney-client privilege, a trend that has been in evidence (like the melting of the polar ice caps) for some time now.¹

It is the second demand, however, that is even more troubling: Lawyers (at their clients’ direction) giving up to the government opinion work product—such “classic” work product is surely going to constitute the most damaging evidence to be used back against one’s clients. And it is not just the government that will make use of such evidence; it will also be the plaintiffs’ lawyers who follow in the government’s wake, because the law is fairly clear that once these genies are out of the bottle they cannot be jammed back in when the plaintiffs’ bar comes a’knocking.²

What can lawyers do to mitigate (as opposed to eliminate) this very troubling downside? First off is to have corporate clients understand the mixed blessing/danger of the “silver platter”—such cooperation may prove to the regulators that the company “gets it” and wants to do the “right thing,” but it is also likely to cost the company more severe sanctions and may render its ability to defend itself in suits for money damages effectively a nullity. Not

having a CEO or the audit committee understand such consequences is not fulfilling one’s professional obligations.

Another thing to consider is that cooperation with the government might (legitimately) have its limits—i.e., contemplate waiving attorney-client privileged communications (the underlying facts are discoverable anyway), but not giving up attorney work product (or, as a back-up, resist producing core opinion work product). Corollaries to this notion are: (i) be very, very careful about creating opinion work product (especially on computers)—i.e., employ The New York Times test before you commit to writing your views of client conduct; and (ii) be careful where you keep opinion work product—i.e., it is a lot more difficult for clients to know what outside lawyers have created (and thus direct that it be produced), so long as the work product stays at the law firm and does not make its way into company files or computers.³

• The Bloodhound Factor. Another downside consideration about which to be mindful is that an investigation once launched cannot be turned off; a lawyer may well uncover additional wrongdoing and (like a bloodhound) will have to follow wherever the evidentiary trail leads him or her. Thus, what might have started as a relatively minor matter may turn into a life-threatening event to the company.⁴

Furthermore, neither management nor the board can or should endeavor to limit the scope of an investigation at the outset. A circumscribed investigation will have no credibility with the government; indeed, such a limitation will likely have a significantly negative impact on a company’s ability to repair its bona fides with prosecutors and regulators. And the danger of not doing a thorough job—to both clients and lawyers—is amply illustrated by the carefully tailored investigation done by Vinson & Elkins into Enron’s off-balance sheet activities.⁵

• Other Danger Signs. Investigations can be dangerous in other ways, as well. For example, corporate lawyers need to be aware of client

disclosure obligations vis-à-vis the results in various Securities and Exchange Commission filings, separate and apart from attorney disclosure obligations that have been created under Sarbanes-Oxley.⁶ Also increasing is the danger that investigations pose to corporate personnel; companies are now expected not only to jettison quickly any officers and employees who might be implicated or be seen as part of the "problem," they are also being called upon to violate their own bylaws (and Delaware corporate law) and deny these same individuals their contractual rights to indemnification and/or advancement—rights without which they usually cannot defend themselves.⁷

Another challenge comes from those charged with oversight responsibility for corporate books and records. Not surprisingly, any investigation of the type discussed herein is likely to have some material impact on those financials. As such, auditors are likely to demand to have complete access to the same documents and attorney reports presented to the board. And while that is certainly understandable, what is also clear is that, upon providing auditors such access, the materials in question will have lost their privileged and protected nature.⁸

Just how dangerous corporate investigations can be was recently demonstrated when the government used the fruits of an investigation by an esteemed law firm to indict a number of corporate officers for violating 18 U.S.C. 1001. The theory for proceeding against those individuals was that the private lawyers were, for all practical purposes, government officials when they conducted interviews during their investigation. Lying to those private lawyers was thus deemed the equivalent of lying to the U.S. Attorney or an F.B.I. agent.⁹

The 'Uglies' of Investigations

Conducting corporate investigations has gotten harder, not easier. One obvious reason is that company employees are (by and large) smart. Any corporate officer who remembers that the three principal witnesses in the criminal trials against Frank Quattrone were senior lawyers from his company is likely to conclude that spilling his or her guts to corporate lawyers may be bad for one's health.

Compounding that practical problem is the ethical issue of when a lawyer must reveal to a corporate individual that he or she may not be a client. Per the ABA's Model Rule 1.13 (which many states have adopted), a lawyer (regardless of whether he or she is an in-house or outside attorney) must give what is often called the Corporate Miranda Warning "when the lawyer knows or reasonably should know that the organization's interests are adverse" to the individual's. New York has a very different standard, however; the warning must be given when "it appears that the organization's interests may differ" from the

individual's. New York lawyers, therefore, must give this (chilling) warning far earlier in an investigatory process, something that is likely to make ascertaining the facts more problematic.

Another issue corporate counsel need to be mindful of is the understandable desire of outside lawyers to want to represent companies not only for purposes of the investigation, but also for the private litigations that inevitably follow. This desire (driven, inter alia, by business considerations) does not, in my view, cross any ethical line per se; but it could call into question the objective nature of the investigation, and could also lead to sword and shield dangers in the ensuing litigations (i.e., using the investigation's result to defend the company while attempting to bar disclosure thereof on privilege and work product grounds).¹⁰

What is clear is that lawyers and their corporate clients need to make sober, considered decisions before they take the internal investigation fork.

Conclusion

With all the foregoing "bads" and "uglies" it is perhaps not surprising that the paradigm for corporate investigations may already be changing. In the WorldCom corporate train wreck, for example, the government intervened to curtail the company's investigation into its own (alleged) wrongdoing; even though the investigation was being conducted by a distinguished lawyer (a prior head of the SEC's Enforcement Division), the government decided that it wanted "to go first"—to get to the company's executives and other witnesses prior to their being "horse-shedded" and prior to private counsel getting all of the company's ducks in a row.¹¹

An even starker example happened in late 2004 when the New York Attorney General, then looking into practices in the insurance business, informed the board of Marsh & McLennan not only that the company faced indictment, but that his office would no longer deal with current management. There being no time for an investigation (or anything else), the board within days cashiered management (including the general counsel), put in place a new CEO who was a former professional colleague of the attorney general, and launched a full-scale peace offensive (the result of

which was an historic payment of \$850 million and a formal "apology" to Marsh's clients).¹²

Paradigm change or not, what is clear is that lawyers (particularly in-house counsel) and their corporate clients need to make sober, considered decisions before they take the internal investigation fork. As in a chess match, it is important to have a good understanding of what the chess board might well look like in six, nine and 12 months, after various events have played out. A company's health (financial and otherwise) are at stake when an investigation is undertaken, as are the futures (professional and otherwise) of numerous individuals; even doing an investigation exactly right is no guarantee of a happy ending.

1. See C.E. Stewart, "The Attorney-Client Privilege: The Best of Times, the Worst of Times," *The Professional Lawyer* (March 2000).

2. There is only one U.S. Circuit Court of Appeals (the Eighth Circuit) that has adopted the concept of "selective waiver" (i.e., a waiver of privileged/protected material to regulators does not constitute a waiver to third parties). No other circuit, however, has followed that court's lead.

3. See *In re Murphy*, 560 F.2d 326 (8th Cir. 1977). See C.E. Stewart, "Corporate Counsel and Attorney Work Product," *New York Law Journal*, Nov. 8, 1993 (Before memorializing anything as important as your views with respect to client conduct, think of how it would look on the front page of *The New York Times*.).

4. A former head of the SEC Enforcement Division once publicly observed that not a working day goes by in the securities industry without firms violating the securities laws. This correct observation underscores how dangerous open-ended investigations can become.

5. See C.E. Stewart, "Liability for Securities Lawyers in the Post-Enron Era," 35 *Rev. Sec. & Comm. Reg.* 171, 177-79 (Sept. 11, 2002). See also *FDIC v. O'Melveny & Myers*, 969 F.2d 744 (9th Cir. 1992), rev'd, 114 S.Ct. 2048 (1994), on remand, 61 F.3d 17 (9th Cir. 1995).

6. See C.E. Stewart, "The SEC and the Lawyer-Client Relationship: A Revolution in the Making," *Compliance Reporter* (Feb. 9, 2004).

7. See C.E. Stewart, "When the Government Comes Knocking," *GC New York*, *New York Law Journal* (March 14, 2005). For a recent example of governmental pressure upon companies to deny individuals their rights under corporate bylaws, see *U.S. v. Wittig/Lake*, No. 03-40142-01/02 (D. Kan.).

8. See e.g., *In re Subpoena Duces Tecum (Willkie Farr & Gallagher)*, 1997 U.S. Dist. LEXIS 2927 (S.D.N.Y. 1997).

9. See C.E. Stewart, "Law Enforcement and Law Practice in the Post-Enron Era," *Compliance Reporter* (June 21, 2004) (investigation undertaken by Wachtell Lipton Rosen & Katz of Computer Associates). This statute, which also was the basis of Martha Stewart's criminal conviction, is one of the broadest and scariest criminal statutes extant. It does not require, for example, that a Miranda warning be given to the "interviewee."

10. See *In re Kidder Peabody Securities Litigation*, 168 F.R.D. 549 (S.D.N.Y. 1996).

11. See D. Solomon and S. Pulliam, "U.S. Wants WorldCom to Halt Probe," *The Wall Street Journal*, A3 (July 5, 2002).

12. See supra 7. That lawyers representing clients in regulated industries can often be seen as part of the problem is becoming an increasing issue. Beyond the sea changes in lawyer liability codified in Sarbanes-Oxley, it was recently disclosed that SEC lawyers are keeping contemporary records as to the cooperative nature of lawyers with whom they are adverse on enforcement matters.

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