



## Internal Investigations in the Era of “Cooperation”

Originally presented at the CLE International Seminar, Atlanta, GA, May 20, 2005.

Written by:

Michael K. Wolensky  
t 404.437.7030  
mwolensky@schiffhardin.com

**SCHIFF HARDIN LLP**  
One Atlantic Center, Suite 2300  
1201 West Peachtree Street  
Atlanta, GA 30309-3574  
t 404.437.7000  
f 404.437.7100

[www.schiffhardin.com](http://www.schiffhardin.com)

## I. Overview: Why Conduct an Internal Investigation

A. The quandary for a business enterprise with questions of possible wrongdoing resolves itself into a simple issue: why take a complaint, claim or suspicious circumstance and develop information that may point to civil liability, regulatory action or even criminal exposure and, inevitably, to bad publicity?

The answers aren't easy, but this question must be addressed and the appropriate factors weighed. The factors include:

- duty of the entity to comply with the law and to demonstrate its compliance efforts;
- avoidance of harm or additional harm to investors, customers and the firm;
- the adequacy of internal controls and supervisory procedures;
- regulatory considerations;
- statutory obligations; and
- the potential for cooperating with a government inquiry.

Internal investigations may arise in a variety of ways, and uncover a wide range of problems. Underlying many internal investigations is corporate conduct that can trigger confrontations on a number of fronts. The failure to recognize this reality at the outset will greatly diminish the overall effectiveness of the investigation.

As a consequence, there are several types of internal investigations. One is purely reactive, arising in reaction to some external event — for example, a grand jury subpoena, a document request by the SEC or other governmental agency, an administrative audit, or a private lawsuit. Another is proactive — the firm conducts the internal investigation on its own initiative in order to determine whether what initially appears to be an isolated incident really represents widespread wrongdoing and, if so, to take remedial steps. Finally, many internal investigations fit into neither category but are a mixture of both.

The type of internal investigation will likewise determine the scope of the assignment to those charged with performing it. If the investigation is a reaction to a government initiative, the internal investigation may be limited to the allegations under scrutiny. But, if the investigation is proactive, management may instruct counsel to look into a variety of issues within a broad subject matter. The result could be a far different internal investigation, with different questions regarding the attorney-client privilege, the team

assembled to conduct the investigation, and the supervision by firm management.

Generally speaking, an internal investigation will enable the firm to make informed decisions

- to halt improper conduct;
- to prepare a defense to civil, regulatory, or criminal charges;
- to determine if additional systems and procedures are required; and
- to weigh whether a report to governmental officials is necessary or appropriate and to demonstrate proper "cooperation."

## B. The Investigator

After determining that an internal investigation is necessary, the firm must decide whether the investigation should be conducted by in-house counsel or whether outside counsel should be retained, and what other professional assistance is required. Frequently, it will be necessary for the firm to use non-employee resources to conduct an inquiry in order to have sufficient credibility where the government has become involved.

1. *Investigations by In-House Counsel.* In-house counsel frequently is the best person to conduct an internal investigation. Use of in-house counsel may be more cost efficient and the start-up time in the investigation may be shorter because they are knowledgeable about the firm's business, procedures and employees. When the firm management has no prior knowledge and is not implicated in the alleged wrongdoing, and when there is not a conflict or appearance of conflict, in-house counsel may conduct an effective internal investigation. These situations include:

- claims of self-dealing or taking of corporate property by employees or related persons; and
- violations of employment laws or internal personnel policies by corporate employees.

2. *Investigations by Outside Counsel.* In determining whether outside counsel should be used to conduct an investigation, the firm must assess whether in-house counsel possesses the necessary ability, resources and objectivity to conduct the investigation. In-house counsel should never be asked to investigate corporate officials with the power to affect his or her future. The independence of outside counsel may be essential in order to lend weight and credibility to the conclusions of an investigation where the alleged wrongdoing is widespread or involves high-level employees, where an allegedly

improper activity has attracted significant adverse publicity, and where a derivative action has been brought and the board of directors has established an independent litigation committee to investigate possible claims against officers, directors or others in response to a shareholder demand letter or lawsuit.

In addition to the issue of credibility, the other factors that should be considered in determining whether to retain outside counsel include outside counsel's expertise in conducting internal investigations and its working relationship with government agencies; outside counsel may have a better ability to preserve claims of privilege; and the limited resources available to in-house counsel.

## II. The Investigative Process

The first step in any investigation is to place a "litigation hold" or "do not destroy request" on all relevant documents and information. This means that any employees known to have any involvement in the matters being investigated should be directed and advised regarding their obligations to preserve both paper and electronic documents, including suggesting specific steps that should be taken to preserve relevant evidence and identifying a person within the organization to serve as contact if any questions arise about preservation duties. Once the hold is in place, the other investigative processes can develop.

### A. Witness Interviews

1. The witness interview may be the most important task performed during the internal investigation. Despite the importance of this process, lawyers too often treat witness interviews as a necessary routine not requiring substantial preparation or expertise and the investigation may be tainted at the outset when witnesses are interviewed by untrained personnel. Interviews should not be undertaken before those responsible have fully considered the purposes of the interview, determined the key factual and legal issues, and reviewed the critical documents.

The most common mistake in internal investigations is to conduct all the witness interviews at the outset of the investigation. Although this course may be necessary when the government is also conducting an investigation, it is often preferable to postpone most of the critical or detailed witness interviews until after the key preliminary steps have been taken.

2. The nature of the interview process is determined by the purpose and timing of the internal investigation. Thus,

before scheduling witness interviews, those responsible should ask several questions:

- What is the purpose of the internal investigation?
- What legal questions—including the assessment of both legal vulnerabilities and defenses—will be addressed at the end of the investigation?
- What are the potential uses of the investigation's findings and the investigator's work product?
- Is there a risk that certain inquiries could stir the interest of the company's potential adversaries and thus foster litigation adverse to the company?

The answers to these questions could influence the pace, structure, content, and order of the witness interviews. For instance, witness interviews may proceed in an entirely different order if they are being conducted in response to a government investigation rather than in response to a management request for an investigation of alleged employee misconduct. In the former situation, the order of witness interviews may be determined by the order the government seeks to interview employees, or even the order grand jury subpoenas are served. In the latter situation, by contrast, the lawyer conducting the internal investigation will have more control over the sequence and pace of the employee interviews.

Before undertaking detailed witness interviews, the person conducting the investigation must determine the legal issues to be answered during the investigation. Too often, internal investigations focus on only one side of an issue—finding fault without assessing defenses, or documenting defenses without adequately assessing vulnerabilities. The full picture can emerge from the interviews only if the interviewer knows at the outset what the possible sources of legal defenses might be.

Knowing beforehand whether the investigation is likely to lead to a voluntary disclosure also can influence the way the interviews are recorded. For example, although it is recommended that two people attend each interview, only one person should take notes, and a single memorandum of the interviews should be prepared. After the memorandum is prepared, all notes should be discarded routinely.

Finally, those conducting the investigation must be conscious of the risk that the investigation itself might prompt employees or others to initiate litigation against the company. Such a risk can influence the scope of the investigation, the number of employees interviewed, and even whether disgruntled former employees are interviewed at all. Any decision to limit the scope of the

investigation should, of course, be made by those directing the inquiry, not by those retained to conduct the investigation.

3. Several general organizing principles guide the conduct of interviews in internal investigations.

(a) First, it is best to gather and analyze the documents before beginning witness interviews. Documents can be used to refresh a witness' recollections, structure interviews, and help determine whether a witness is being truthful. Since it is best to assume the interviewer will have access to a witness only once—though, it is often possible to have more than one interview—it is important to be ready to ask all questions in the first instance.

(b) Second, except in unusual circumstances or to learn answers to routine questions, written questionnaires should not be used in lieu of face-to-face interviews. Though the responses are protected by the attorney-client privilege,<sup>1</sup> questionnaires often create more problems than they solve. The responses to questionnaires are not protected as work product because they do not reflect the lawyer's mental impressions.<sup>2</sup> Thus, should there be a waiver of the attorney-client privilege—or if the privilege never attached—the responses cannot be protected. This is particularly problematic because the answers are presented in a manner over which the lawyer has no control. If those answers turn out to be incorrect or misleading, the use of a questionnaire will have caused significant problems.

The one useful purpose of a questionnaire is to determine answers to basic questions that will help organize an investigation, such as who in a company has done business with a particular competitor or who has sold particular products to a particular foreign country. Therefore, we recommend the investigators gather the facts by conducting face-to-face interviews.

(c) Third, if possible, counsel should interview witnesses before the government does, because a witness' testimony often gels in the interaction with the first person to discuss the issue. Moreover, facts that may refresh a witness' recollection can be brought to the witness' attention before a government interview. When a witness' recollection is refreshed after a government interview or testimony, it is often difficult to correct the record with maximum credibility. In addition, once witnesses have

been interviewed by the government, they are often reluctant to change their testimony, even if they become aware of new facts later that conflict with their earlier version.

(d) Fourth, if time permits, it is best to interview lower level employees first and work up to higher-level employees. When time is of the essence, the interviewer may have to go directly to the person who—based upon events and documents—is most likely to be knowledgeable. In any event, interviews should not be undertaken without a clear understanding of the corporate hierarchy and the interrelationships among personnel.

(e) Fifth, if possible, witnesses with knowledge of the same aspect of a transaction or subject of inquiry should be interviewed by the same person. While witness interview memoranda can summarize the facts gathered in an interview, they rarely communicate all the facts and they are inadequate to communicate the witness' intellect or quality of memory, factors that may be important to the ultimate conclusions reached in an investigation.

4. As more and more internal investigations become the subject of efforts to cooperate with the government, legal and ethical issues have arisen regarding what warnings the investigating lawyer should give the witness at the outset of the interview. If the investigation is undertaken by counsel pursuant to a company's attorney-client privilege, the employee must be advised that the interviewer represents the company, not the individual employee. The employee also should be told that the interview is being conducted pursuant to the company's attorney-client privilege, and that this privilege can be waived by the company at any time, but not by the witness. These admonitions are essential, not only to maximize the company's choices in deciding what to do with the investigative results, but also to ensure that employees understand they are not speaking to their own lawyers.

The underpinnings of the work product protection and the attorney-client privilege also must be established at the outset of the interview. It must be made clear that the interview is intended to gather facts the company needs so counsel can provide the company with legal advice in anticipation of litigation. This is particularly important when an informal internal review is being undertaken. An investigation—particularly one undertaken in-house by a non-lawyer—may well be held to be unprotected because it is not focused on possible litigation. It must be clear that the information is sought and will be maintained in confidence.

<sup>1</sup> *Upjohn Co. v. United States*, 449 U.S. 383, 397 (1981).

<sup>2</sup> See *In re Grand Jury Investigations*, 599 F.2d 1224, 1230 (3d Cir. 1979).

There does not seem to be much debate that the warnings must be given to employees at the outset of the interviews. The debate begins with whether the interviewer is obligated either to warn the witness that the witness' statements may be used against him or to advise the witness to retain counsel.

5. Some basic principles can be applied to most interviews.

(a) Generally, it is important to treat the witness with respect, regardless of what may have been done or how abusive the witness may be (some corporate employees resent the intrusion of a lawyer into what they believe to be a business matter). It is generally not helpful for counsel to inject their own personality or personal views into the interview itself, to become engaged in an argument or discussion with the witness on the matter under investigation, to use the occasion to advise the witness on how the witness should have handled the situation in issue, or to disclose how the investigation is proceeding (although some sharing of information is often necessary for a productive interview).

(b) Interviews should be planned and structured so that the easy, less contentious issues arise first. So-called "nondirective" interviewing — relying on open-ended questions — is best used at the beginning of an interview to get the witness' version of events in an unfettered manner. This can be followed by a step-by-step, pointed review of the facts, utilizing documents or a time line, in which more precise answers are sought.

(c) Effective interviewing, like effective cross-examination, requires the pursuit of two occasionally inconsistent goals: (1) following up on leads provided by the witness' responses to questions, and (2) ensuring that the witness has answered the questions propounded.

6. Whenever an internal investigation precedes or shadows a government investigation, the government will be looking for conduct by corporate counsel that was intended to, or did, affect the tenor and shape of the witness' testimony. During witness interviews, the investigators should use extreme care to avoid any suggestion of fostering possible false or misleading conduct by the witness.

7. Document Review and Analysis

(a) Experience teaches that witnesses are often reluctant to supply information voluntarily, especially when such information may implicate their own misconduct or that of a co-worker. Use of documents, therefore,

becomes essential in uncovering the underlying facts. While documents may not reflect reality, they are the best means for getting at the truth.

Witness recollections of events often fade with time, and also may be inconsistent with recollections of other witnesses. Documents — especially key documents — are essential in the process of refreshing a witness' memory and also might provide counsel with certain insights in reconciling conflicting recollections of employee witnesses.

(b) At the outset of any internal investigation, the learning curve is great, and thousands of documents may have potential relevance. Ultimately, this curve must be mastered, through education, or through reasonable assumptions, or both. Once this is done, the universe of relevant documents can often be reduced to a group of key records essential to an understanding of past events and those critical to presenting an affirmative case for the firm. This group should include any documents that are problematic or susceptible to a problematic interpretation.

The major objectives of the document portion of the internal investigation are to:

- ensure a comprehensive review;
- work with minimal disruption of a client's business, and maximum cost efficiency;
- preserve the original integrity of all documents;
- protect all applicable privileges, confidences, and proprietary secrets; and
- avoid unnecessary duplication of effort in the event the investigation ends in criminal or civil litigation.

With these objectives in mind, the typical phases of the documentary portion of the internal investigation are:

- Organization and planning;
- Gathering and Processing;
- Analysis; and
- Preparation of summaries and chronologies.

(c) Analysis is the key to document processing. Generally, in order to comprehend the importance of a document, it is helpful to have an understanding of the firm's managerial structure—that is, who answers to whom. In planning the gathering of documents, it may be very helpful to understand the document flow through the firm—that is, as a general matter, who would see specific documents and when they would be expected to see the documents in the chain. Documents that were handled outside the norm or contrary to the firm's written policy should receive special scrutiny.

(d) Various tools should be employed to organize documents and document-based facts in a comprehensible fashion. Chronologies, "key word" summaries, computer data bases searchable by key words, micrographics, imaging and direct document input are all useful methods, with varying costs, for document control and analysis.

(e) If the internal investigation parallels a government-sponsored investigation — such as an SEC formal order investigation — it is essential for the firm to demonstrate control, integrity and the completeness of the document gathering process. Both the firm and outside counsel may be called upon to vouch before the government that the client has appropriately complied with the government document subpoena. In order for counsel to be in a position to make any representation regarding the compliance with the subpoena, counsel should consider controlling the document gathering process.

### III. Protecting Those Subject to Investigation

#### A. The Employee Perspective

1. During every internal investigation, the lawyer must balance his or her duty to implement the firm's legitimate right and duty to make an exhaustive investigation of all pertinent facts, while at the same time protecting the rights of employees. Many of the rights and obligations of employees and employers participating in internal investigation are not entirely clear. In some cases, these rights and obligations will vary depending on the applicable state statute, the corporation's bylaws, the lawyer's ethical considerations and the facts of the case. In other cases, these rights and obligations have not been clearly defined.

2. A duty to cooperate exists in every employer/employee relationship, and most states either have statutes defining the scope of this duty, or the courts have concluded that the employee's duty to cooperate is implicit or implied by law in every employer/employee relationship. Because of the duty to cooperate, an employee is obligated to comply with all lawful, reasonable directions from an employer during an internal investigation. The issue of whether the directions are reasonable depends upon the basic duties for which the employee was hired.

The fundamental question is whether the duty to cooperate obligates an employee to consent to an interview by the firm's lawyer during an internal investigation. Subject to the employee's rights, we believe the answer to this question is "yes," as long as the interview addresses matters within the scope of employment duties. If the employee refuses to consent to an interview, the firm may be entitled to terminate employment.

As a practical matter, to ensure that the employee is under a duty to cooperate in the internal investigation, the company should consider providing a memorandum directing the employee to participate in the investigation. This memorandum would provide the basis for the company to assert that the employee has a duty to cooperate in the internal investigation.

3. Rights of employees generally vary in each case depending upon the employee's contract, any applicable statutes, and constitutional provisions. Prior to starting any internal investigation, it is imperative to determine the employees' rights so the firm will not be exposed to suits for wrongful termination or other torts arising out of actions of the corporate counsel during the internal investigation.

4. The general rule is that the United States Constitution does not limit the powers of private employers in conducting internal corporate investigations. Consequently, private employers generally are not liable under federal or state law for violating the employees' constitutional rights because there is no state action in corporate internal investigations. The actions of a regulated entity, however, may be considered state action when there is a sufficient nexus between the government and the regulated entity that its actions can be treated as the actions of the government itself. When this occurs, the constitutional protections are implicated and apply to the private entity.

5. The employee's right to counsel in an internal investigation depends upon the facts of the employee's particular circumstance. Absent state action or a special statute, the Sixth Amendment right to counsel does not apply to private employees in internal investigations. Thus, in these circumstances, an employee would not be entitled to have counsel present for an investigatory interview. Ethical obligations and practical considerations, however, may mandate that an employee have separate counsel under some circumstances.

It is imperative that a lawyer performing the internal investigation only represent the firm. If a lawyer attempts to perform dual representation of the employee and the firm, the lawyer jeopardizes the relationship to both clients.

#### B. The Firm's Perspective

1. One of the most controversial issues in an internal investigation is whether the company may discharge an employee for failing to cooperate in the investigation. The ability to terminate for noncooperation with an internal investigation varies with state law, the employee's contract, and the facts of each case. Yet, as internal investigations

become more frequent, more firms and company counsel will be faced with this dilemma.

During the investigation, an employee may refuse to cooperate by asserting the right against self-incrimination. This right should not apply to private employers unless there is state action or a special state statute. Even if the right does apply, the company may still terminate the employee if the evidence establishes that the employee was involved in an improper activity. In this regard, the firm should continue its investigation and attempt to independently determine the involvement of the recalcitrant employee. The firm must then weigh the strength of the evidence of wrongdoing against the employee, the need for the information from the employee, whether the employee is actually a target of an investigation by law enforcement, and the extent of the employee's refusal to cooperate. Under these circumstances, an employee's failure to discuss work-related events should constitute good cause for termination. Even where there is state action or a state statute, the fact that the employee asserts a right against self-incrimination should not change the result.

2. A matter of great concern to any employee involved in an internal investigation is whether the firm will pay for separate counsel. As with other areas of the law regarding employee rights in an internal investigation, the question of whether a firm can or should reimburse employees for participating in an internal investigation is unresolved.

A firm's ability to indemnify its employees for attorney's fees incurred from participating in an internal investigation is controlled by the applicable state law and the bylaws of the corporation. Most states have statutes that require mandatory reimbursement of fees once the employee has been successful on the merits in defense of any action in which the employee is a party because of activities as an employee. These mandatory statutes, however, do not address whether an employee is entitled to recover attorney's fees for participating in an internal investigation. In our experience, absent strong evidence of intentional harm to the firm, most firms provide separate counsel where requested or necessary.

#### IV. The Attorney-Client Privilege and Work Product Doctrine

##### A. Scope Of The Protections

Generally, the attorney-client privilege and the work product doctrine can be asserted to protect the confidentiality of communications and materials generated in connection with an internal investigation conducted under the auspices of lawyers. However, recent decisions

have made it clear that the privileges will not be automatically upheld simply because the person conducting or supervising the investigation is a lawyer. The firm must be able to establish the traditional elements of these privileges in order successfully to rely upon them to defeat discovery requests or other documents for disclosure by private litigants, regulators or the government for materials that may serve to guide them through the documents and witnesses necessary to prove a case against the firm and to overcome valid defenses. Moreover, the government may put pressure on the company to waive the confidentiality, wholly or in part, in the furtherance of demonstrating cooperation.

##### B. The Attorney-Client Privilege

1. The attorney-client privilege generally protects communications between a lawyer and the client for the purpose of enabling the lawyer to render legal advice. It was defined in *United States v. United Shoe Machine Corp.*, 89 F. Supp. 357, 358-59 (D. Mass. 1950), in a passage that is frequently quoted:

The privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

2. Business enterprises may assert the privilege. However, since a corporation may act only through individuals, it is important to keep in mind which individuals represent the firm for these purposes. In *Upjohn Co. v. United States*, 449 U.S. 383, 394-95 (1981), the Supreme Court articulated the factors supporting a claim of privilege in connection with corporate employee interviews: (1) At the direction of the corporate superiors (2) there was a communication with an employee of the corporation who was aware of the legal implications of the communication (3) to corporate counsel acting in his capacity as such (4) concerning matters within the scope of the employee's duties and (5) concerning information not available from upper -echelon management (6) which information was

necessary to permit the corporation to receive legal advice (7) in circumstances where the communications were understood to be confidential when made and (8) where the communication had not been disclosed.

3. Where other experts are retained to assist the lawyer conducting the investigation, statements made to and from these assistants should be privileged if their services are a necessary aid to the rendering of effective legal services to the client. However, it is important to adequately document the fact that the investigator or expert has been retained to assist with the rendering of legal advice. This protection may extend to all documents prepared by the expert.

4. It is critical to note that the privilege protects only the attorney-client communication, it does not protect the underlying pre-existing facts from disclosure. The Supreme Court stated in *Upjohn*:

[T]he protection of the privilege extends only to communications and not to facts. A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question, "What did you say or write to the attorney?" but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney.

### C. Work Product Doctrine

1. The work product doctrine provides another basis to protect the confidentiality of materials generated during an internal investigation headed by a lawyer. In contrast to the attorney-client privilege, which exists to protect lawyer/client communications, the work product doctrine protects against the disclosure of an attorney's mental impressions, conclusions, opinions or legal theories in order to prevent lawyers from benefiting from an adversary's labor. The doctrine applies to materials created in anticipation of litigation.

2. The work product doctrine was formally acknowledged by the Supreme Court in *Hickman v. Taylor*, 329 U.S. 495 (1947), when the Court refused to allow discovery of materials prepared by counsel. The Court held that:

In performing his various duties . . . it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel. Proper preparation of a client's case demands that he assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare

his legal theories and plan his strategy without undue and needless interference . . . . This work is reflected, of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways - aptly though roughly termed . . . the "work product of the lawyer." Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten.

*Id.* at 510-11.

The reasoning of *Hickman v. Taylor* has been codified in the Federal Rules of Civil Procedure. Rule 26(b)(3) provides generally that:

a party may obtain discovery of documents and tangible things otherwise discoverable . . . prepared in anticipation of litigation . . . by or for another party . . . only upon showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case . . . . In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

3. In light of the higher level of protection afforded to opinion work product, it is important to include, where possible, counsel's thought processes and opinions in documents which might otherwise be classified as factual work product. Interview notes and memoranda should reflect the author's mental impressions and legal theories and should not appear to consist merely of verbatim transcriptions.

### D. Protecting Information During An Internal Investigation

1. In order to invoke the attorney-client privilege and the work product doctrine in the context of an internal investigation, the investigation must have a primarily legal purpose. To memorialize that legal advice is being sought, written authorization from the Board of Directors or senior officers of the firm should be obtained.

2. During the investigation, the number of copies of all documents should be severely limited and copies should go only to those on the investigative team and members of senior management who really need to see the document. Any documents prepared in connection with the investigation should bear an appropriate legend at the top

designating the document as: Privileged and Confidential: Attorney-Client/Work Product. Interview notes should reflect counsel's mental impressions and legal theories and should not be verbatim transcripts.

3. Any documents generated by the firm's employees should specify that they have been produced at the direction of counsel.

#### E. The Self-Evaluative Privilege

Creative lawyers may also try to protect the fruits of their investigative labor by invoking something a few courts and commentators have referred to as the "self-evaluation" or "self-critical analysis" privilege. It has not been broadly recognized and, where it has been, it has then found favor in only a limited context.

### V. Considerations Upon Completion of the Internal Investigation

A. Once the investigation has been completed, the firm is faced with a number of choices that can have a substantial impact upon the future of the organization. Some of the choices will have been made early in the process, but even those will be revisited to account for the results of the investigation and developments during the period the inquiry was being conducted.

Among the decisions to be made are:

- whether a written report should be prepared and, if so, the form the report should take;
- to whom within the firm's management will the results of the investigation be provided, either orally or in writing;
- whether a report to a court, the government, or a regulatory body is required or desirable in order to demonstrate the firm's cooperation;
- whether employees should be advised of the results;
- whether remedial or preventative procedures are warranted;
- whether disciplinary action against employees is warranted; and
- whether a public announcement should be made.

B. A key decision is whether any written report should be prepared. The initial reaction is usually "why not?" While a written investigative report may upon first consideration seem an indispensable conclusion to an internal investigation, one must proceed with great caution. One might conclude that there is no better way to persuade firm management of the necessity of remedial action, or government lawyers of the legality of your position, that a

well-reasoned, comprehensive statement in writing. Some reasons for having a report include:

- By providing detailed information about questionable business activities and their legal implications, the report can be a valuable aid in deciding what steps, if any, to take in addressing the matter.
- If wrongdoing is identified, a report offers tangible evidence that an internal corporate investigation has been performed and that corrective action is underway. This may forestall a more intrusive government investigation and can be used in settlement negotiations with government agencies.
- Government agencies may require the preparation of a written report and access to the report, or at least a summary of the report.
- When not required by government counsel, a detailed report of fact and law may be an important tool in persuading government lawyers that misconduct did not occur and that criminal or civil proceedings should not be brought.
- In the context of a derivative action, a written report may be used as evidence in support of a motion by the board of directors to terminate a lawsuit.

Yet these benefits are accompanied by a variety of risks, all quite serious.

- A written report may contain evidence that, if discovered in later litigation, may spawn or strengthen lawsuits against the client that commissioned the report.
- A written report may result in the opening up virtually all underlying files in an ensuing SEC or SRO investigation, as well as later, related private litigation, if the report is used (or leaked) for a business purpose.

In short, internal investigative reports can cause disputes as well as resolve them. And, not infrequently, lawyers and clients have wished the reports had never been prepared.

In light of the serious risks that attend its presentation, a written report should be avoided where possible in favor of an oral report to a select firm officer, special committees, or members of the board of directors. The oral report minimizes many, though not all, of the risks associated with conducting an investigation, since the primary documents used in making the presentation, counsel's notes, are afforded virtual absolute protection under the work-product doctrine. An oral report provides needed flexibility to investigative counsel if ever compelled to testify about the investigation and its findings. Conversely, a written report

necessarily confines later testimony to the expressed statement of facts, opinions and conclusions found within the report.

In instances when a written report is considered essential, either as a means of dissuading government action or of spurring remedial action within the company, the issue then becomes how best to structure the report and the underlying internal investigation to minimize the risks of discovery and liability.

C. For securities industry registered entities, the question of whether the results of an investigation showing wrongdoing should be disclosed is often a foregone conclusion.

1. In the broker-deal context, regulations may require disclosure of wrongdoing in particular situations.

- NYSE Rule 351(a)(1) requires a member firm to report whenever an employee “has violated any provision of any securities law or regulation, or any agreement with or rule or standards of conduct of any governmental agency, self-regulator organization, or business or professional organization. . . .” Because a determination that a violation has occurred triggers a filing obligation, the investigation should be sensitive not to describe conduct as being violative of a law or rule until the conduct has been thoroughly evaluated.
- NYSE Rule 351(a)(10) requires disclosure of disciplinary action taken against an employee “involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or any other significant limitation on activities.”
- Rule 351(e) requires broker-dealers on a quarterly basis to report to the NYSE any unresolved, internal investigations into possible insider trading in NYSE-listed securities by member firms or their employees.
- NASD reporting requirements where disciplinary actions are concerned are similar to those of the NYSE.

-- NASD Form U-4 (question 22I) requires disclosure if an employee is the “subject of any complaint, investigation or proceeding” that could result in a finding of a violation or reportable event. In this context, “investigation” refers to government or SRO investigations and proceedings, which often result in one or more of the specified reportable events, but not internal reviews. Moreover, internal investigations often focus on the adequacy of a firm’s activities, procedures and practices and

not necessarily on the conduct of a particular employee.

-- NASD Form U-5 (question 15) requires, with respect to terminated employees, reporting whether the individual “[c]urrently is, or at termination was . . . under internal review for fraud or wrongful taking of property or violating investment-related statutes, regulations, rules or industry standards of conduct.”

2. On the other hand, there may be advantages to a firm making voluntary disclosure of the results of the investigation.

- By voluntarily disclosing wrongdoing, a broker-dealer or investment adviser can place the misconduct in the best possible light, assert defenses where appropriate, and argue mitigating circumstances.
- Such disclosure may persuade regulators to forego or at least be reasonable in any settlement of an enforcement action, especially where remedial action has been taken.
- But, voluntary disclosure has disadvantages in that it may alert regulators to wrongdoing and prompt action generating adverse publicity and may serve to waive the attorney-client and work-product protections with respect to the entire investigation, and give rise to, or adversely affect the ability to defend suits.

## VI. Conclusion

As with most matters of this kind, it is important to start with the end in mind. While one must avoid the temptation to design an investigation to confirm what is suspected – a path too often followed by the government – do not disregard the obvious or suspend your disbelief merely because of the source. The stakes are high for all concerned; treat the task accordingly.

## About the Author

Michael K. Wolensky focuses his practice on securities litigation and market regulation matters. He represents clients in New York Stock Exchange, Securities and Exchange Commission, National Association of Securities Dealers, and state investigations and related litigation, including white collar matters. He conducts internal investigations for corporations and regulated entities. Mr. Wolensky also represents parties in arbitration proceedings and counsels investment advisers, money managers, and broker dealers. Prior to entering private law practice, Mr. Wolensky served in a series of increasingly senior attorney and legal administrative positions at the SEC for 16 years.

## About Schiff Hardin LLP

Schiff Hardin LLP is a general practice law firm representing clients across the United States and around the world. We have more than 400 attorneys in offices located in Atlanta, Boston, Chicago, Lake Forest, New York, San Francisco and Washington.

As a general practice firm with local, regional, national, and international clients, Schiff Hardin has significant experience in most areas of the law. For more information visit our Web site at [www.schiffhardin.com](http://www.schiffhardin.com).

*This article has been prepared for general information. It is not meant to provide legal advice with respect to any specific matter. The reader should consult a lawyer regarding specific legal advice.*