

How to Conduct Internal Investigations

By Jonathan S. Sack



One of the toughest things many in-house counsel will ever have to do is take that walk into a senior executive's office to say that the company has a "problem" and needs to do an investigation. The attorney and the executive both know that an investigation is likely to be distracting and expensive, and it may well be divisive and have serious consequences for the company.

However, in the vast majority of cases the problems raised are manageable, or they turn out not to be problems at all. Under those circumstances investigations can be turned into opportunities. It's crucial to keep two points in mind at the outset, one relating to means, the other to ends.

With regard to means, an investigation is not an all-or-nothing proposition, where the company either declines to look into an issue or does an extensive archeological dig of its business. Investigations can be tailored to specific issues, and if necessary shifted or widened in response to the facts gathered.

As to ends, an investigation must above all be reliable and credible to all the constituencies that will be interested. Those include directors, senior management, shareholders, independent auditors

and government agencies. This means that the conclusions and recommendations of the investigation need to be convincing to a skeptical observer.

These goals of an investigation – focus and discipline on the one hand, credibility and reliability on the other – reinforce each other. What follows is a discussion of how to achieve them, beginning with the question of how an issue may first arise, how that affects the scope of the investigation, and how choices about who the client should be and who should conduct the investigation will advance the integrity of the investigation.

First, some terminology. What is an internal investigation?

It's an investigation that is conducted by a company about its own conduct, be it a specific event or transaction or, more generally, its policies and practices. This is in contrast to an external investigation, which is conducted by a government agency, such as a state attorney general or the Department of Justice.

An internal investigation ordinarily

should be conducted by in-house or outside counsel, because the facts gathered by counsel and the resulting conclusions usually are protected by attorney-client privilege and the work product doctrine. Conversely, if business people or internal auditors (or even compliance officials) conduct the investigation, the privilege will not apply, unless it is clear that they are working under the supervision of attorneys for the purpose of providing legal advice.

It should be noted that protection of the privilege can be a challenge in international investigations, because foreign jurisdictions, including the European Union, often do not treat discussions between company employees and in-house counsel as privileged.

With regard to the scope of an investigation, issues raised about a specific transaction or relationship may have broader implications – if the issues turn out to be genuine and serious, and if the conduct is persistent and widespread. This does not mean an investigation must be wide-ranging and intrusive at the start.

To take one example, the question of the

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scope of an investigation will arise when allegations of corruption – for example, in the FCPA context – must be addressed. If one relationship in a single country may have been corrupt, can the investigation focus safely on that relationship, or must similar relationships be investigated?

Usually an internal investigation should be targeted and not become a company-wide inquiry at the outset. As a practical matter, the initial scope of an investigation will depend on the specificity of the allegations that trigger it. If the allegations are vague, shaping the initial inquiry will be a challenge.

Once the matter to be examined is clarified, unless a widespread problem is suspected, it's reasonable for a company to begin an investigation by targeting the specific conduct that is the subject of the initial allegation. As the investigation progresses, the company should make a careful judgment as to whether and how much to broaden the inquiry. It may be appropriate to keep the scope narrow if the problem is discrete, but if it's thought likely to appear elsewhere it may be necessary to widen the investigation.

There are a variety of ways that a company can learn of an issue warranting investigation. Regular compliance efforts or internal audits are almost certainly the best route. Another way is through an employee seeking advice from in-house counsel. An issue can also be raised by an employee communicating directly to a supervisor or in-house counsel, or indirectly and perhaps anonymously through an internal hotline or other means of reporting legal compliance issues.

In the latter instance, involving an actual or potential whistleblower, response and investigation have become increasingly thorny and challenging issues. Laws against retaliation make it more complicated to take personnel actions, even very reasonable ones, during an investigation. In addition, new whistleblower bounty rules under the Dodd-Frank law risk establishing adversity between the company and the source of information.

A company may realize it needs to do an internal investigation only after it learns that a government investigation has already begun. This situation can put constraints on the internal investigation. The government may seek to limit whom the company can interview, and individuals may be less likely to provide information if they fear prosecution. As a practical matter, counsel may find it difficult to conduct an investigation while defending the company.

What's critical is that counsel investigate the facts both to support the defense and to guide senior management. The scope of the internal investigation may be the same as or broader than the

government investigation. The company's primary consideration should be the company's defense, and the investigation should be tailored to enhance, not hinder, that defense.

If a news story raises an issue, a company should consider the report's credibility and the likelihood of a follow-on government investigation. If that is deemed likely, then the observations above are operative. If it's unlikely, the company may reasonably begin with a specifically tailored and targeted inquiry and assess how to proceed as the investigation progresses.

Whatever the source of the information, the overriding principle remains the same: Clearly define the issue or issues to be addressed at the outset so that the company can learn the right facts in a timely manner and act accordingly, knowing that as new facts emerge, the issues to be examined may change.

Who is the client? Depending on the circumstances, the possibilities include company management, a committee of the board of directors (such as the audit committee or a special committee formed to oversee the investigation), or the board of directors as a whole. Generally, who will be the controller of the investigation – that is, who the client is – will depend on whether the issues being reviewed encompass actions of senior management or are confined to mid and lower-level employees.

When the issues involve senior management, to ensure the integrity of the investigation it should be overseen by a board committee that has independence from management. However, when alleged wrongdoing by mid and lower-level employees is the issue, senior management can oversee the investigation and report the results of the investigation to the board or to a board committee. The integrity of the investigation is paramount, so the client must be independent and free from the influence of wrongdoers.

Is outside counsel necessary? Not necessarily. Often it makes sense for in-house lawyers to undertake an initial inquiry, taking care to protect privilege, in order to assess the problem and gather the basic facts. At that point, the company can

determine whether to retain outside counsel. If the company then decides it does need outside counsel, it will know enough about the matter to select counsel with the specific expertise required.

When the initial inquiry points to the need for broader investigation by outside counsel, the question becomes whether to retain the company's regular corporate counsel or engage independent counsel. Although regular corporate counsel generally has more extensive knowledge of a company's business, it has become common for companies to retain counsel without prior ties to the company or its management for important investigations. This is especially true when the investigation may touch directly or indirectly on the conduct of senior management, and when the results of the investigation are likely to be disclosed in some forum outside the company.

Remember that the eventual contours of an investigation cannot be determined at the outset. A good internal investigator ordinarily begins with a discrete and carefully defined issue, or issues, and adapts and shapes the investigation as the facts develop. In some cases it will remain narrowly circumscribed, while in others it will widen, sometimes substantially, when facts emerge. In either event, rigor about the subject and scope of an investigation will promote the integrity of the findings. ■



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