



**WhitefordTaylorPreston<sup>LLP</sup>**

# **THE ROLE OF THE BOARD OF DIRECTORS IN THE AGE OF CORPORATE INVESTIGATIONS**

**Presentation to  
The Baltimore Chapter of  
The Association of Corporate Counsel**

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**D. Scott Freed (*410-347-8763*; [sfreed@wtplaw.com](mailto:sfreed@wtplaw.com))  
Frank S. Jones, Jr. (*410-347-8707*; [fjones@wtplaw.com](mailto:fjones@wtplaw.com))  
William F. Ryan, Jr. (*410-347-8741*; [wryan@wtplaw.com](mailto:wryan@wtplaw.com))  
Whiteford, Taylor & Preston L.L.P.  
Seven Saint Paul Street  
Baltimore, Maryland 21202**

# THE ROLE OF THE BOARD OF DIRECTORS IN THE AGE OF CORPORATE INVESTIGATIONS

## I. OVERVIEW

Increasingly, boards of directors are being called upon to initiate and oversee independent corporate investigations (“ICIs”) to address allegations or concerns that company employees or other representatives have violated either law or corporate policy or otherwise engaged in misconduct. Deciding to launch an ICI is a complex and difficult decision. Managing an ICI is fraught with peril. Properly conducted, an ICI can be highly effective at ferreting out wrongdoing, insulating the company and its directors from liability (or at least limiting the penalties) and promoting good governance. Poorly conceived or managed, an ICI can be a colossal waste of company resources that advances no worthwhile corporate goal. For directors trying to “do the right thing” while creating shareholder value, the stakes have never been higher.

## II. BOARD OVERSIGHT AND OTHER DUTIES

### A. Increasing Scrutiny of Board Compliance and Duties Generally

1. *Backdrop.* Recent corporate scandals have put directors under the magnifying glass and their actions are often scrutinized at the first hint of corporate misconduct. Boards (and audit committees) are more frequently turning to ICIs as a method of fulfilling their oversight rules.

2. *Basic Board Duties.* Members of a corporation's board of directors generally owe the corporation and its shareholders a duty of loyalty and a duty of due care. The duty of due care refers to “the responsibility of a corporate fiduciary to exercise, in the performance of his tasks, the care that a reasonably prudent person in a similar position would use under similar circumstances.”<sup>1</sup>

3. *Maryland Corporations.* Under the Maryland General Corporation Law (“MGCL”), directors must perform their duties in good faith, in a manner that they reasonably believe to be in the corporation’s best interests and with the care that an ordinarily prudent person in a similar situation would exercise. MD. CODE ANN., CORPS. & ASS’NS §2-405.1(a). Acts or omissions by a director that conform to this standard of conduct cannot be the basis for director liability. MGCL §2-405.1(c).

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<sup>1</sup> Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984).

B. Recent Case Law Emphasis on “Director Oversight” and the Board’s Obligation of “Good Faith”

1. *In re Caremark Int’l, Inc. Deriv. Lit.*<sup>2</sup> In this seminal case, the plaintiffs sought to hold directors liable for negligent oversight, as opposed to negligent decision-making. In *Caremark*, then-Chancellor Allen theorized that it might be possible to premise a breach of fiduciary duty claim on an alleged failure to exercise adequate oversight. The Chancellor also cautioned that when a claim of director liability is based on ignorance of corporate wrongdoing: “only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.”

2. *Stone v. Ritter*. In *Stone v. Ritter*<sup>3</sup>, the Delaware Supreme Court refined the circumstances under which the *Caremark* framework will result in director oversight liability. As refined by the Supreme Court in *Stone*, the *Caremark* standard results in director oversight liability where “(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, “consciously failed to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring their attention.”

3. *Nature of the “Good Faith” Standard*. In approving and applying the standard, the *Stone* Court clarified that “the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty.” Instead, it determined that “[w]here directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, **they breach the duty of loyalty by failing to discharge that fiduciary duty in good faith**” (emphasis added).

4. *Potential Impact on Director Exculpation and Indemnification Provisions*. A finding that the Board lacked good faith in carrying out its oversight responsibilities can have devastating consequences by rendering unavailable exculpation from liability for monetary damages for breaches of the duty of care and may also render indemnification unavailable.<sup>4</sup>

**III. OTHER RECENT TRENDS CAUSING AN INCREASE IN THE NUMBER OF INVESTIGATIONS**

A. The Sarbanes-Oxley Act of 2002<sup>5</sup> (“SOX”). SOX requires that audit committees have in place procedures to receive and address whistleblower complaints. SOX also

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<sup>2</sup> 698 A.2d 959 (Del. Ch. 1996).

<sup>3</sup> 911 A.2d 362 (Del. 2006).

<sup>4</sup> See, e.g., §§102(b)(7) and 145 of the Delaware General Corporation Law.

<sup>5</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

expressly prohibits retaliation against whistleblowers.<sup>6</sup> Audit committees of public companies are also responsible for overseeing the company's obligations relating to internal controls over financial reporting mandated by SOX.<sup>7</sup> SOX also requires an attorney "appearing and practicing before the Commission" to report "evidence of a material violation by the issuer or by any officer, director, employee or agent of the issuer."<sup>8</sup> Often when reporting such a violation, counsel advises the company to commence an ICI to ensure an "appropriate response."

B. Exchange Act Section 10A. Section 10A of the Securities Exchange Act of 1934 (the "Exchange Act") requires a company to conduct an ICI if a "registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred."

C. More Severe Penalties; New Incentives to Cooperate. Recent amendments to the U.S. Sentencing Guidelines have resulted in more severe penalties for individuals and companies that violate criminal laws, while rewarding companies that have self-reported violations, cooperated with government investigations and adopted compliance programs, including mechanisms for investigating alleged misconduct.<sup>9</sup> Similarly, policies adopted by the U.S. Department of Justice, the SEC and other regulatory agencies now reward self-reporting, cooperation, and effective compliance programs.<sup>10</sup> In addition, Congress has created new crimes (e.g., securities fraud, money laundering, obstruction of justice, and retaliation against whistleblowers) and increased penalties. Finally, the government has devoted greater resources to the enforcement of laws related to corporate misconduct generally.<sup>11</sup>

#### IV. INITIATING AND CONDUCTING AN INVESTIGATION

##### A. When to Consider Conducting an ICI

1. Internal and/or outside auditor finding of questionable/improper practices
2. Receipt of employee or other "whistleblower" complaint

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<sup>6</sup> SOX §301.

<sup>7</sup> SOX §404.

<sup>8</sup> SEC Release Nos. 33-8185, 34-47276 (enacting SOX §307).

<sup>9</sup> See U.S. Sentencing Commission Guidelines Manual §2B1.1 (penalties for fraud) and §8B2.1 (elements of an effective compliance program).

<sup>10</sup> See, e.g., U.S. Dep't of Justice, Memorandum from Deputy Attorney General Paul McNulty to Heads of Department Components Re: Principles of Federal Prosecution of Business Organizations (December 12, 2006) (the "McNulty Memorandum"), available at [www.usdoj.gov/dag/speeches/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf) replacing and superceding earlier guidelines issued in 2003 by then-Deputy Attorney General Larry Thompson (the "Thompson Memorandum") available at [www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm); Statement of the SEC Concerning Financial Penalties, available at [www.sec.gov/news/press/2006-4.htm](http://www.sec.gov/news/press/2006-4.htm).

<sup>11</sup> In 2005 alone, the SEC brought more than 600 new enforcement actions against issuers, and their directors and officers. This extraordinary number is in addition to the numerous ongoing SEC formal and informal investigations.

3. Administrative enforcement proceeding by a government agency
4. Civil suit alleging wrongful conduct
5. News media reports
6. Other

B. Benefits of Conducting an ICI

1. Identify and stop the improper conduct
2. Uncover the identity and role of the person(s) responsible for the conduct
3. Foster an informed assessment of the legality/propriety of the conduct
4. Provide an opportunity to make an informed decision whether and how to take corrective or disciplinary action, including whether to self-report
5. Contain the damage to the bad actors; prevent it from metastizing to the company, the board or others

C. Risks of Conducting an ICI

1. Can be very expensive, distracting, disruptive and decidedly non-strategic
2. Possible creation of an inaccurate or misleading record that portrays the company in an unnecessarily harsh light or that calls into question the motive for launching the ICI in the first place
3. Waiver of privileges (inadvertent or otherwise)
4. May be impractical or at least difficult to limit the ICI's scope
5. Public leaks of confidential or sensitive information
6. Negative publicity/IR concerns
7. Can trigger affirmative disclosure obligations

D. Different Types of ICIs Serve Different Purposes

1. Self-directed, i.e., prompted and commenced at the direction of:
  - a. The Board
  - b. Audit Committee
  - c. Chief Legal Officer
  - d. Other company representative
2. Investigations conducted in an attempt to cooperate/preempt other bodies
  - a. Government regulators (e.g., SEC or DOJ)
  - b. Self-Regulating Organizations (a/k/a SROs; e.g., NYSE or FINRA<sup>12</sup>)
3. Investigations prompted by auditor concern pursuant to Exchange Act §10A

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<sup>12</sup> The Financial Industry Regulatory Authority is the SRO under the Exchange Act and successor to the National Association of Securities Dealers, Inc.

E. Who Oversees the Investigation?

1. The full Board?
2. The Audit Committee?
3. A special Board committee of independent directors?
4. A “Qualified Legal Compliance Committee”<sup>13</sup> under SOX?

F. Assembling the Team; Role of Counsel & Experts

1. *Counsel vs. Non-counsel*
  - a. Not every investigation warrants counsel
  - b. Cloaking ICI in attorney-client and work product privileges can be a real advantage
2. *Inside GC vs. Outside Counsel*
  - a. Avoid conflicts of interest; maintain ICI’s “independence”
  - b. Attorney-client and work product privileges can more clear if outside counsel used
3. *Regular Outside Counsel vs. Independent Counsel hired for the ICI?*
  - a. Avoid conflicts of interest; maintain ICI’s “independence”
  - b. Significant experience with ICIs
  - c. Credibility with regulators or other relevant constituencies
  - d. Resources to move quickly
  - e. Insurance coverage may dictate an approved list of counsel
4. *Limited Role for Company's Existing Outside Auditor*
  - a. Avoid conflicts of interest; maintain ICI’s “independence”
  - b. If auditors are included in the actual conduct of the ICI, any privilege applicable to the ICI may be waived, yet participation may be practically needed
    - (i) Auditors must be given the assurances necessary to allow them to rely on the results of the ICI when preparing the company's financial statements

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<sup>13</sup> A “Qualified Legal Compliance Committee” is a committee that an issuer may form (which also may be an audit or other committee of the issuer) to consider and investigate allegations of a material violation of U.S. federal or state securities law, a material breach of fiduciary duty arising under U.S. federal or state law or a similar material violation of any U.S. federal or state law.

- (ii) Can the company merely apprise its auditors of the ICIs' final conclusions in summary form so as to avoid waiving the privileges?

5. *Special/Independent/Forensic Accountants*

6. *Forensic IT*

7. *Others?*

8. *Who hires the experts?*

Strong consideration should be given to having outside ICI counsel, rather than the client, retain the expert to increase the likelihood that communications involving the expert are protected by the attorney-client privilege and that all documents created by the expert are considered work product

#### H. Establishing the Scope of the Investigation

1. Existence or non-existence of a government investigation or private lawsuit is a critical factor in deciding whether to conduct an ICI as well as its scope
2. Who should determine the scope?
  - a. ICI Counsel and controlling body should determine at the outset
    - (i) If in response to a government investigation, the scope of the ICI generally should mirror that of the government investigation
    - (ii) If ICI is self-directed, counsel and controlling body should agree on scope based on precise reason for the ICI
  - b. If the ICI is being conducted pursuant to Exchange Act §10A, the company's auditor will want (and should) have input
  - c. Care should be taken to ensure that scope is not broader than necessary
  - d. However, scope often changes and expands depending upon findings
3. Memorialize scope and process in a written preliminary investigative plan
4. Counsel's engagement letter should clearly state that:
  - a. Counsel has been asked to investigate certain allegations

- b. ICI is being conducted to enable counsel to provide legal advice and advise the company regarding its legal rights, obligations and potential liabilities
- c. All communications with counsel are protected by the attorney-client privilege and are intended to remain confidential and protected

## I. Gathering The Needed Evidence

1. *Secure all Potentially Relevant Evidence at the Outset.* It is all but impossible to overstate the critical importance of preserving and protecting all relevant evidence at the earliest stage possible. At the outset:

- a. Identify the “key players” involved
- b. Contact the IT department to suspend all automated deletion processes and preserve all e-mails and back-up tapes for all relevant employees for all relevant periods
- c. Contact records department (including any off-site records management vendor) to suspend any routine document destruction and preserve all relevant records for all relevant periods
- d. Secure hard drives (don’t forget the laptops) and network drives of all relevant employees
- e. Issue memorandum to all employees and other affected individuals with a clear directive to preserve all evidence in any form, including home computers, portable media (e.g., flash drives, CDs) and handheld electronic devices (e.g., blackberries, PDAs), and cooperate fully with the investigation; emphasize that there are potentially adverse consequences for employees and the company if relevant information is not preserved
- f. Consider obtaining signed certificates of compliance with preservation instructions
- g. Issue and document periodic reminders regarding the preservation obligation

2. *Empower ICI Counsel.* ICI Counsel should be given direct and unlimited access to those witnesses with any possible relevant information and all relevant documents.

## J. Document Retention Generally

### 1. *Role of Counsel*

- a. The obligation to preserve evidence runs first to counsel. Counsel then has a duty to advise and explain to the client its obligations to retain documents that may be relevant to the litigation.<sup>14</sup>

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<sup>14</sup> See Telecom Int'l. Am., Ltd. v. AT&T Corp., 189 F.R.D. 76, 81 (S.D.N.Y. 1999).

- b. Counsel to the company also has on-going obligation to monitor the company and its representatives with respect to their obligations with respect to the document retention.<sup>15</sup>

2. *Multiple Document Retention Regimes*

- a. Retention of documents is necessary under SOX, as well as pre-SOX statutes and case law proscribing the destruction of evidence for the purpose of interfering with government proceedings and investigations as a crime
- b. Parallel body of state statutes that punishes interference with state investigations
- c. Every state and federal jurisdiction recognizes “spoliation” (*i.e.*, the destruction or alteration of evidence relevant to pending or future litigation) as wrongful conduct
- d. Spoliation exposes private litigants to various sanctions and evidentiary penalties, including monetary fines, adverse inference instructions, and exclusion of witnesses

3. *General Document Retention Advice*

- a. Establish, implement and follow written retention policies for both paper and electronic documents
- b. Establish a “legal-hold” process that identifies potential events that trigger a duty to preserve documents and implement procedures to suspend document destruction
- c. Designate a point person to be notified when any potentially relevant documents are slated for destruction
- d. Establish, implement and follow written policies regarding employee use of personal e-mail for business, Internet, IM, blogging, *etc.*
- e. Establish points of contact in various departments who can coordinate the preservation and collection of documents from their respective departments if necessary

4. *Additional Electronic Discovery Considerations*

- a. Above considerations are heightened because of the complexity and highly fluid nature of e-discovery in the aftermath of the December 1, 2006 amendments to the Federal Rules of Civil Procedure governing the discovery of electronically stored information

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<sup>15</sup> See, e.g., *Zubak v. UBS Warburg LLC*, No. 02 Civ. 1243 (SAS), 2004 WL 1620866 (S.D.N.Y. July 20, 2004).

- b. Cases involving e-discovery generally focus on document management in the context of litigation discovery, but the potential pitfalls are equally present in the context of an ICI
- c. The retention of an expert is an important first step
  - (i) The expert should understand all types of media and operating systems, including e-mail packages
  - (ii) The expert should be able to search data by keywords, eliminate duplicate documents, limit searches by relevant time period, and suggest how confidential information can be protected
  - (iii) The expert should be capable of preserving documents in native format, if necessary

K. Managing Communications with the Client; to whom Should ICI Counsel Report?

- 1. Point person on Audit or other special committee?
- 2. Management excluded from process?
  - a. An initial goal in determining to whom counsel should report is to identify an individual or group who:
    - (i) has authority to act upon the results of the investigation
    - (ii) is truly independent of the alleged wrongdoing and wrongdoers
    - (iii) will be perceived by third parties as independent
  - b. To the extent the management team does not meet these characteristics, they generally need to be excluded from the investigation. Possible alternative contacts:
    - (i) In-house counsel
    - (ii) Corporate compliance officer
    - (iii) Board of directors
    - (iv) Audit committee (if ICI involves financial reporting issues, counsel should to report to the committee in order to discharge its oversight duties)
    - (v) Special committee comprised independent directors (often utilized for litigation such as shareholder derivative actions)

V. **ATTORNEY-CLIENT AND WORK PRODUCT PRIVILEGES**

A. Generally

- 1. *Attorney-Client Privilege.* Applies to protect information shared between a lawyer and a client where the information is: (a) a communication, (b) made in

confidence, (c) between a person who is, or is about to become, a client, (d) a lawyer, and (e) for the purpose of obtaining legal advice or assistance.<sup>16</sup>

2. *Work Product Doctrine.* Materials prepared in anticipation of litigation are protected from discovery unless the party seeking discovery has a “substantial need” for the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. If the party seeking discovery makes the required showing, the court can order discovery, but in doing so, 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.<sup>17</sup>

## B. The Upjohn Decision

1. *Generally.* In Upjohn Co. v. United States,<sup>18</sup> the Court held that ICI counsel's communications with company employees are protected by the company's attorney-client privilege under certain circumstances

2. *Upjohn Guidelines.* The Court set forth the following guidelines for determining when the company's privilege applies to corporate employees: (a) whether the communications were made by corporate employees at the direction of superiors for the purpose of obtaining legal advice; (b) whether the communications contained information necessary for counsel; (c) whether the matters communicated were within the scope of the employee's corporate duties; (d) whether the employee knew that the communications were for the purpose of the company obtaining legal advice; and (e) whether the communications were ordered to be kept confidential by superiors

3. *Privilege Belongs to the Company.* Remember that the privilege exists for, and belongs to, the company and not to its employees

## C. Issues of Waiver

1. Ordinarily, courts will find that disclosure of a written report concerning an ICI constitutes a waiver of both the attorney-client and work product privileges<sup>19</sup>

2. Query: Can the company selectively waive the privilege?

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<sup>16</sup> In re Richard Roe, Inc., 68 F.3d 38, 39 (2d Cir. 1995).

<sup>17</sup> Federal Rule of Civil Procedure 26(b)(3).

<sup>18</sup> 449 U.S. 383, 394-96 (1981).

<sup>19</sup> *See, e.g., In re The Leslie Fay Companies, Inc. Sec. Litig.*, 161 F.R.D. 274 (S.D.N.Y. 1995) (holding that production of audit committee's report to the SEC waived attorney-client privilege, not only for the report itself, but for all documents underlying the report). In re Sealed Case, 676 F.2d 793 (D.C. Cir. 1982) (rejecting claim of privilege after disclosure to SEC). In re Steinhardt Partners, L.P., 9 F.3d 230 (2d Cir. 1993) (voluntary submission of legal memorandum effectively waived work product privilege).

- a. Can the company disclose the report to government regulators without risking a waiver of the privilege's application to the report with respect to potential third party litigants?
  - (i) Some courts have upheld the concept of selective or “limited” waiver in the context of voluntary corporate disclosures of internal investigative findings to government agencies<sup>20</sup>
  - (ii) Other courts have rejected the concept of a limited waiver<sup>21</sup>
- b. There is also authority for the proposition that limited disclosure of the report's findings and conclusions will not waive the protection afforded to the report by the privilege<sup>22</sup>

3. Query: If the government agrees to enter into a confidentiality agreement and promises to keep any privileged materials confidential, is the privilege protected?

- a. The SEC generally endorses the practice of using confidentiality agreements to preserve the company's privilege as to third party private litigants in related civil actions
  - (i) “[A]llowing issuers to produce internal reports to the Commission without waiving otherwise applicable privileges serves the public interest [and] preserving the privilege or protection for internal reports shared with the

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<sup>20</sup> See, e.g., Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1978) (finding limited waiver of the attorney-client privilege where company disclosed privileged material to the SEC pursuant to an agency subpoena in a separate, nonpublic SEC investigation); In re LTV Sec. Litig., 89 F.R.D. 595, 620-21 (N.D. Tex. 1981) (“The voluntary disclosure of information to an agency, as part of an agency enforcement proceeding, often is viewed as only a partial waiver of the attorney-client privilege”); Byrnes v. IDS Realty Trust Co., 85 F.R.D. 679, 687- 89 (S.D.N.Y. 1985) (endorsing the limited waiver theory outlined in Diversified Indus. Inc.).

<sup>21</sup> See, e.g., United States v. Mass. Inst. of Tech., 129 F.3d 681, 686 (1st Cir. 1997) (finding waiver of both the attorney-client and work product privileges by disclosure to the Defense Contract Audit Agency pursuant to contracts between MIT and the Department of Defense); In re Steinhardt Partners, L.P., 9 F.3d 230, 236 (2d Cir. 1993) (finding waiver of work product through voluntary disclosure to the SEC); Westinghouse Elec. Corp. v. Republic of the Philippines, 951 F.2d 1414, 1431 (3d Cir. 1991) (finding waiver of both attorney-client and work product privileges due to disclosure to the SEC and Department of Justice of ICI for purposes of cooperation); In re Martin Marietta Corp., 856 F.2d 619, 623-24 (4th Cir. 1988), *cert. denied*, 490 U.S. 1011 (1989) (finding that, where privileged material had been disclosed to the U.S. Attorney and Department of Defense, all related attorney-client material and all related non-opinion work product material would be discoverable).

<sup>22</sup> In re Dayco Corp. Derivative Secs. Litig., 99 F.R.D. 616 (S.D. Ohio 1983) (The Dayco court stated that since, “the press release did not summarize evidence found in the report, nor did it purport to combine those findings with those of the directors, it had not effected a waiver of the privilege); In re Witham Memorial Hospital, 706 N.E.2d 1087 (Ct. App. Ind. 1999) (court held that because the press release did not “compromise the confidentiality of the report itself, the communications between the attorneys and the investigator during the investigation, or the analysis contained in the report,” privilege was not waived).

Commission does not harm private litigants or put them at any kind of strategic disadvantage.”<sup>23</sup>

(ii) “[F]or these reasons, the Commission will continue to follow its policy of entering into confidentiality agreements where it determines that its receipt of information pursuant to those agreements will ultimately further the public interest, and will vigorously argue in defense of those confidentiality agreements where litigants argue that the disclosure of information pursuant to such agreements waives any privilege or protection.”

- b. Some courts have suggested that production pursuant to a valid confidentiality agreement preserves the privilege and does not amount to a waiver as to third parties<sup>24</sup>
- c. Other courts have held that confidentiality agreements cannot prevent waiver of disclosed material<sup>25</sup>

#### 4. *The McNulty Memorandum*

On December 12, 2006 the Department of Justice released revised guidelines regarding the federal prosecution of business organizations (“McNulty Memorandum”). Among other things, the McNulty Memorandum requires prosecutors to obtain prior senior supervisory approval -- starting at the level of the United States Attorney and rising to the Deputy Attorney General -- before seeking corporate waivers of attorney-client privilege and attorney work product. Pursuant to this new approach, requests for protected materials will only be made where there is a "legitimate need" for privileged information, to be determined by:

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<sup>23</sup> See Implementation of Standards of Professional Conduct for Attorneys, SEC Release Nos. 33-8185, 34-47276 (Jan. 29, 2003).

<sup>24</sup> See, e.g., Dellwood Farms, Inc. v. Cargill, Inc., 128 F.3d 1122 (7th Cir. 1997) (intimating that privilege would not have been waived had the possessor of the privilege “been more careful, as by obtaining an agreement by the person to whom they made the disclosure not to spread it further”); In re Subpoenas Duces Tecum, 738 F.2d 1367, (D.C. Cir. 1984) (to protect the privilege, “the company can insist on a promise of confidentiality before disclosure to the SEC”); Maruzen Co. v. HSBC USA, Inc., No. 00 Civ. 1079 (RO), 2002 WL 1628782, at \*1 (S.D.N.Y. July 23, 2002) (finding no waiver of work product protection where defendants had explicit confidentiality agreement with the U.S. Attorney's Office); In re M & L Business Mach. Co., 161 B.R. 689, 696 (D. Colo. 1993) (stating that allowing limited confidentiality agreements “strives to balance the policy goal of encouraging cooperation with the government with the strict requirement of confidentiality”).

<sup>25</sup> See, e.g., Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414 (3d Cir. 1991) (“Even though the DOJ apparently agreed not to disclose the information, under traditional waiver doctrine a voluntary disclosure to a third party waives the attorney-client privilege even if the third party agrees not to disclose the communications to anyone else.”); In re Columbia/HCA Healthcare Corp., 2002 WL 1270187, at \*14 (6th Cir. June 10, 2002) (rejecting “any form of selective waiver, even that which stems from a confidentiality agreement”).

- a. the likelihood and degree to which the privileged information will benefit the government's investigation;
- b. whether the information can be obtained in a timely and complete fashion by using alternative means that do not require waiver;
- c. the completeness of a voluntary disclosure already provided; and
- d. the collateral consequences to a company resulting from a waiver.

If prosecutors determine that such a legitimate need exists, they are instructed to seek information through the “least intrusive manner” possible.

5. *Self-Critical or Self-Evaluative Privilege.*

- a. In general, the self-critical analysis privilege may apply to protect self-evaluating documents created during a company's ICI if the following criteria are met:
  - (i) the information results from self-critical analysis undertaken by the party seeking protection
  - (ii) the public has a strong interest in preserving the free flow of the type of information sought
  - (iii) the information is of the type whose flow would be curtailed if discovery were allowed<sup>26</sup>
- b. “A privilege of self-critical analysis or a self-evaluative privilege serves the public interest by encouraging self-improvement through uninhibited self-analysis and evaluation.”<sup>27</sup>
- c. It is unclear if the “privilege” will apply to an ICI report. There is no direct authority on point and while there are many cases upholding the application of the self-critical privilege generally,<sup>28</sup> others decline to apply the self-critical privilege generally.<sup>29</sup>

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<sup>26</sup> Note, *The Privilege of Self-Critical Analysis*, 96 *Harvard Law Review* 1083, 1086 (1983).

<sup>27</sup> *In re Health Management, Inc.*, No. CV 96-0889 (ADS), 1999 WL 33594132 at \*7 (E.D.N.Y. Sept. 25, 1999).

<sup>28</sup> *See, e.g., In re Health Management, Inc.*, No. CV 96-0889(ADS), 1999 WL 33594132 at \*7 (E.D.N.Y. Sept. 25, 1999); *Lasky v. American Broadcasting Cos., Inc.*, No. 83 Civ. 7438 (JMW), 1986 WL 9223, at \*2-3 (S.D.N.Y. Aug. 13, 1986) (holding that certain documents in question were protected by the self-critical privilege); *New York Stock Exchange v. Sloan*, No. 71CV2912, 1976 WL 169086, at \*4-5 (S.D.N.Y. Oct. 21, 1976) (recognizing self-critical privilege in securities law context).

<sup>29</sup> *See, e.g., In re Ashanti Goldfields Securities Litigation*, 213 F.R.D. 102, 105 (E.D.N.Y. 2003); *Robinson v. U.S.*, 205 F.R.D. 104, 108-109 (W.D.N.Y.2001) (noting that the self-critical analysis privilege has not been adopted by the Second Circuit Court of Appeals and has been rejected in the relevant district); *Spencer v. Sea-Land Service, Inc.*, 1999 WL 619637 (S.D.N.Y. Aug. 16, 1999).

C. Conducting Employee (and Former Employee) Interviews

1. *Standard UpJohn Warning*

“We are company counsel; what you say may be privileged; but it is the company's right to waive any privilege that may apply”

2. *How to Handle Employees Who Ask if They Should Obtain Their Own Counsel*

“You may obtain counsel; we have no opinion on whether you should do so; the company may not pay for it.”

3. *Consider “Mirandizing” all employees*

- a. Counsel represents the company – not the individual
- b. Employees may be punished by the company as a result of what they say to counsel.
- c. The company may divulge what the employee says to the government
- d. If employee is untruthful with counsel, and that untruth is repeated to the government, the employee could be prosecuted for obstruction of justice<sup>30</sup>

D. Who Controls the Privilege?

1. Determined by the answer to the question: Who is the client?

**VI. THE INVESTIGATION REPORT**

A. Should the Report be Written or Oral?

1. *Advantages of Written Reports*

- a. Valuable tool for management in planning the company's response to the allegations of misconduct

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<sup>30</sup> See, e.g., United States v. Zar, No. 04-331 (ILG) (E.D.N.Y. 2004) in which the government alleged that the defendant and other Computer Associates executives gave false information about the company's accounting practices to the company's counsel and to counsel for its Audit Committee, leading to an obstruction of justice claim (under 18 U.S.C. §1512 (c)(2)) based on the allegation that Zar and other executives made these misrepresentations to both the company's law firm and the Audit Committee's law firm with the knowledge and intent that the information would be relayed to the U.S. Attorney's office, the SEC and the FBI, thereby obstructing and impeding government investigations.

- b. Documented record of the scope and findings of the ICI that may be valuable to the company in future litigation or investigations
- c. May be more credible to the SEC and other third parties

2. *Risks Posed by Written Reports*

- a. May discuss potentially illegal or unethical conduct by company employees
- b. If the existence of such a report becomes known, prosecutors or government investigators will likely pressure the company to waive any applicable privilege and to disclose the report
- c. Civil litigants will seek the production of the report during discovery as a roadmap when attempting to prove their case
- d. Much harder to deal with a written document in defending a case, in contrast to an oral report
- e. Potentially easier to leak
- f. Release of written report may waive the attorney-client privilege both for the report and underlying materials<sup>31</sup>
- g. The report may constitute admissions<sup>32</sup>

B. Who Makes the Decision Whether a Written Report Should be Created?

- 1. Full board?
- 2. Audit or other committee?
- 3. Management?
- 4. ICI counsel's input

C. How Detailed Should the Report be?

- 1. The amount of detail necessary depends on the report's intended purpose
  - a. If a primary purpose of the ICI is to convince the government that the company is adequately policing itself and that enforcement action is not warranted, considerable factual detail will likely be required
  - b. If government agencies have already commenced their own investigations into the alleged misconduct, less detail may be more appropriate
    - (i) A more detailed report will provide a roadmap to the government and civil litigants in its prosecution of the company and management
    - (ii) A more detailed report may be treated as an admission of wrongdoing by the company or its management

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<sup>31</sup> See, e.g., Leslie Fay, supra note 18.

<sup>32</sup> See, e.g., Federal Rule of Evidence §801(d)(2).

2. Generally, all reports should:
  - a. Summarize the circumstances that led to the ICI
  - b. Detail the investigative steps that were taken
  - c. Summarize the facts revealed by the ICI
  - d. Identify relevant internal policies, procedures or practices relevant to the events
  
3. Depending on the precise purpose of the ICI, the report also may:
  - a. Analyze the applicable law
  - b. Develop arguments for or against prosecution, sanctions or liability
  - c. Identify steps which the company may take to prevent future violations
  - d. Recommend appropriate remedial actions, such as the implementation of new policies, product recalls or restitution
  
4. If the company intends to disclose the report to the government, it should be drafted with very careful attention to scope:
  - a. When a company has determined that it will make information available to the government, it must decide the extent of the information which it will disclose. For example, it may decide to make the entire report available to the government but try to maintain the confidentiality of the witness interview memoranda and other materials on which the report is based
  - b. If the company's disclosures are too limited, the government will likely seek additional disclosures. On the other hand, the greater the degree of disclosure, the more likely it is that any privilege over other information may be waived
  - c. Cautionary and balanced language should be used in the report regardless of whether the report will be disclosed to minimize the risk that it will later be used against the company

D. Internal vs. External Reports

1. *Internal Report.* Allows the company to determine what went wrong. If the report is only for internal use, counsel preparing the report can be more frank and more critical as the report will generally be privileged
  
2. *Public Report.* If the report is publicized, it may help to address concerns raised by investors and regulators as it shows that the company is seriously addressing the improper conduct. If the report is written for this purpose, it should contain more cautionary language as it could be considered an admission by the company in litigation

- E. To Whom Should the Report be Provided?
1. To the committee or other requesting body
  2. Other possible recipients
    - a. Government
    - b. Auditors
    - c. Marketplace

## **VII. CRIMINAL LAW CONSIDERATIONS**

### A. Perjury

1. 18 U.S.C. §1621 (general perjury statute proscribing willfully false testimony given under oath in any case in which a law of the United States authorizes an oath to be administered)
2. 18 U.S.C. §1623 (applying to false declarations made in proceedings either before or ancillary to any court or grand jury)

### B. Obstruction of Justice

1. A category of crimes, which involve interference with the public administration of justice
2. Three of the general obstruction statutes are relevant in the context of interviewing and preparing witnesses during an ICI<sup>33</sup>

## **VIII. SEC ATTORNEY PROFESSIONAL RESPONSIBILITY RULES**

A. SOX Section 307. Section 307 of SOX and the rules promulgated by the SEC promulgated thereunder require an attorney representing an issuer to report “up-the-ladder” any evidence the lawyer uncovers of a material violation of the securities laws or breaches of fiduciary duties to the company.

### B. Operation of §307's Reporting Obligations

1. The lawyer must first report evidence of the material violation to the company's “Chief Legal Officer” (“CLO”)
  - a. The attorney may also report the alleged violation to the company's CFO
  - b. As part of the lawyer's reporting of the alleged violation, the lawyer must demand that the CLO provide the lawyer with an appropriate response

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<sup>33</sup> See, e.g., 18 U.S.C. §1503, 18 U.S.C. §1505 and 18 U.S.C. §1512.

2. Upon receiving the “report” from the lawyer, the CLO must do one of two things:
  - a. The CLO must investigate the evidence of the material violation presented by the lawyer and either provide an appropriate response or assure the lawyer that no material violation has occurred; or
  - b. The CLO may refer the report to a Qualified Legal Compliance Committee if one has already been put in place by the company
  - c. The SEC has defined a Qualified Legal Compliance Committee (“QLLC”) as a committee of an issuer
    - (i) Consisting of at least one member of the issuer's audit committee (or, if the issuer has no audit committee, one member from an equivalent committee of independent directors) and two or more members of the issuer's board of directors who are not employed, directly or indirectly, by the issuer and who are not, in the case of a registered investment company, “interested persons;”<sup>34</sup>
    - (ii) Has adopted written procedures for the confidential receipt, retention, and consideration of any report of evidence of a material violation;
    - (iii) Has been duly established by the issuer's board of directors, with the authority and responsibility:
      - (A) To inform the issuer's CLO and chief executive officer (or the equivalents thereof) of any report of evidence of a material violation;
      - (B) To determine whether an ICI is necessary regarding any report of evidence of a material violation by the issuer, its officers, directors, employees or agents and, if it determines an ICI is necessary or appropriate, to:
        - i. Notify the audit committee or the full board of directors;
        - ii. Initiate an ICI, which may be conducted either by the CLO (or the equivalent thereof) or by the outside attorneys; and
        - iii. Retain such additional expert personnel as the committee deems necessary; and
      - (C) At the conclusion of any such ICI, to:
        - i. Recommend, by majority vote, that the issuer implement an appropriate response to evidence of a material violation; and
        - ii. Inform the CLO and the chief executive officer (or the equivalents thereof) and the board of directors of the results of any such

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<sup>34</sup> As defined in §2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)).

- ICI under this section and the appropriate remedial measures to be adopted; and
- (D) Has the authority and responsibility, acting by majority vote, to take all other appropriate action, including the authority to notify the Commission in the event that the issuer fails in material respects to implement an appropriate response that the qualified legal compliance committee has recommended the issuer to take.