Internal Investigations And Other Tools

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Michael E. Clark and David L. Douglass

Hate makes you impotent; love makes you crazy; somewhere in the middle you can survive. — *Larry Donner, Throw Momma from the Train (1987)*

ALTHOUGH QUESTIONS have been appropriately raised about the wisdom and efficacy of the accountability statutes and policies promulgated in response to the Enron corporate scandals, there is little reason to anticipate that the government will soon scale back its efforts to regulate corporate conduct through aggressive law enforcement. *See, e.g.*, Michael E. Clark, *Compliance and Governance Issues and Trends after Sarbanes-Oxley*, 2005 Health Law And Compliance Update, at §1.02[A] (Aspen 2005). To the contrary, leading indicators signal increased enforcement efforts. Recent allegations of corporate shenanigans — ranging from options back-dating, to illegal pharmaceutical sales and marketing practices, to unlawful profiteering by publicly held corporations in connection with the war in Iraq and post-Katrina relief efforts — continue to draw public outrage and invite politicians to demand greater corporate accountability and promise even tougher enforcement. Lawmakers, federal enforcement agencies, state attorneys general, and the private plaintiffs' bar (primarily qui tam and class action counsel) claim to be an

integral part of the enforcement web. Thus, when in-house counsel and outside counsel are called upon to respond to allegations of possible corporate misconduct, they will face a complex and dynamic set of demands, challenges, obligations, and risks. To successfully represent a public company or one of its officers, employees, or directors against misconduct allegations typically entails negotiating a veritable minefield of legal challenges and business risks. Counsel must not only be familiar with the applicable laws, regulations, and policies — but also must understand the perspectives, values, and cultures of the enforcement agencies and of any other parties involved. In short, there are many traps for unwary and inexperienced practitioners.

Before immediately discussing various strategies that may be helpful to counsel when confronted with these issues, a brief historical overview is next given about how the enforcement tactics and goals of the different regulatory agencies have evolved in the past few decades.

1. Enforcement Through Regulation: Then And Now

As commentators point out, the attempt to regulate corporate conduct through aggressive law enforcement is not new. *See United States v. Dotterweich,* 320 U.S. 277, 280-281 (1943) *See also, Staples v. United States,* 511 U.S. 600, 629 (1994) (Dissent by Stevens, J.). Beginning in the late 1970s, companies and corporate executives began to encounter a steady and dramatic increase in the intensity of the government's scrutiny of corporate conduct — and the corresponding costs of discovered misfeasance:

"As recently as the early 1980s, most criminal fines imposed on corporations convicted of federal crimes were small. Indeed, 60 percent were less than $10,000; the average fine was only $45,790. Then in 1991, the U.S. Sentencing Commission promulgated guidelines designed to increase sanctions imposed on corporations, particularly the largest corporations. The Guidelines had an immediate effect. Judges governed by the guidelines imposed significantly higher criminal fines. The average fine imposed on publicly held firms jumped to $19 million in the years immediately after the guidelines (1991-1996). … The adoption of the guidelines not only increased criminal fines, they also heralded a dramatic increase in other sanctions imposed on convicted corporations. These sanctions include criminal restitution of gains received and remediation of the harm caused, as well as substantial civil sanctions (imposed by government agencies as well as private actors). Average total sanctions imposed on publicly held firms convicted of federal crimes jumped from approximately $13.3 million pre-guidelines to more than $49 million under the guidelines (1996 dollars)."

Jennifer Arlen, Evolution of Corporate Criminal Liability, Implications for Managers, chapter 17, *Leadership And Governance From The Inside Out* (Robert Gandossy and Jeffrey Sonnenfeld, eds.), at 192-93 (Wiley 2004) (internal notes omitted).

The Evolution of the DOJ's Principles of Federal Prosecution of Business Organizations. The Department of Justice (DOJ) has progressively toughened its stance toward the prosecution of business entities. In 1999, then-Deputy Attorney General Eric Holder issued a controversial memorandum entitled the Principles of Federal Prosecution of Business Organizations (the "Holder Memorandum"). *See* Title 9, United States Attorneys' Manual (USAM) ch. 9-28.000, available at www.justice.gov/usao/eousa/

foia_reading_room/usam/title9/28mcrm.htm. The Holder Memorandum was initially issued in 1999 and it was subsequently revised in 2003 by then-Deputy Assistant Attorney General Larry Thompson, and further revised in 2006 by Deputy Attorney General McNulty, primarily with respect to waiver of the attorney-client privilege as an indicia of cooperation. The Holder Memorandum sets forward the DOJ's general principle that "[c]orporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment." Holder Memorandum, at §I.A.

The Holder Memorandum set out eight factors for DOJ attorneys to consider when evaluating the propriety of charging a business:

"1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management;
3. The corporation's history of similar conduct, including the complicity in, or condonation of, the wrongdoing by corporate management;
4. The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the corporate attorney-client and work product privileges;
5. The existence and adequacy of the corporation's compliance program;
6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;
7. Collateral consequences, including disproportionate harm to shareholders and employees not proven personally culpable; and
8. The adequacy of non-criminal remedies, such as civil or regulatory enforcement actions."

Id., at §II.A. (citations omitted).

The DOJ has encouraged self-policing by offering benefits in the nature of non-prosecution or reduced penalties for making a timely, complete, and voluntary disclosure. In the aftermath of the corporate crises following Enron's collapse and other revelations of misconduct, then-Deputy Attorney General Larry Thompson made critical and controversial modifications to the Holder Memorandum in 2003 in a document widely known as "The Thompson Memorandum." Larry D. Thompson, Deputy Attorney General, U.S. Department of Justice, Memorandum: *Principles of Federal Prosecution of Business Organizations* (Jan. 20, 2003), available at http://www.justice.gov/dag/cftf/corporate_guidelines.htm. The Thompson Memorandum was purportedly intended, at least in part, to provide guidance to corporations and other business organizations about the criteria that the Department uses to evaluate the quality and extent of an organization's corporation. As Thompson explained,

"The main focus of the revisions is increased emphasis on and scrutiny of the authenticity of a corporation's cooperation. Too often business organizations, while purporting to cooperate with a Department

investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions also address the efficacy of the corporate governance mechanisms in place within a corporation, to ensure that these measures are truly effective rather than mere paper programs.

* * *

"Another factor to be weighed by the prosecutor is whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not rising to the level of criminal obstruction). Examples of such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation."

Thompson Memorandum, Introductory Cmt; & §VI.

The reaction of most practitioners to the Thompson Memorandum was hostile, since it was seen as providing little reliable guidance and its demands came at far too high a price. The provision that has drawn the most ire from the business community was the prospect (or requirement) that, in order to be considered to have cooperated with an investigation, an organization had to waive its attorney-client privilege.

After much controversy, in late 2006 then-Deputy Attorney General Paul McNulty issued a subsequent revision ("the McNulty Memorandum") to the Holder/Thompson Memorandum in the face of threatened Congressional action, in which the Department somewhat softened its stance about the privilege-waiver consideration, as explained in the following excerpts from the McNulty Memorandum:

"Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. However, a company's disclosure of privileged information may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure.

"Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation.

"Whether there is a legitimate need depends upon:
(1) the likelihood and degree to which the privileged information will benefit the government's investigation;