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U.S. Regulators Managing Your Relationships in Difficult Times

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These are uncertain economic times. If history is any indicator of the future, public companies can expect increased regulatory attention as the United States and the world work through the current global financial crisis. In speeches made to Congress, the American people and world leaders, President Obama is pressing for and promising reform and more government regulation. Some would say that the United States has the most highly regulated industries in the world. There is no public company that does not have some accountability to a government regulatory agency in addition to the Securities and Exchange Commission ("SEC"). For example, large financial institutions are accountable to federal and state agencies and receive routine requests for information from the FDIC and other federal agencies. The utility industry must respond to federal and state agencies on almost every aspect of their business from rates to emissions. The pharmaceutical and medical device industries face levels of regulatory scrutiny that include research, development, advertising, sales and distribution. As such, in the ordinary course of business, public companies and their in-house counsels are likely to have to respond to inquiries and questions from regulators that may raise questions of civil or criminal liability. With the expected unprecedented increase in scrutiny by government regulators it is imperative that companies are prepared.

In preparation, companies must understand and be attentive to transactions or other circumstances that raise a question about the integrity of any business process. If there is news or claims of possible corporate misconduct or financial irregularities, the actions taken by a company at the first indication of a crisis could have significant ramifications not only for potential criminal or civil litigation, but also in mitigating the potential sanctions imposed by government regulators. At some point while a company is managing this crisis, the government may appear without warning or the company may make a decision to disclose the initial facts related to the crisis to the government. Under either scenario, communication with regulators should be planned and made after careful consideration of the issues. Below is an overview and analysis of the issues in communicating with regulators.

Should We Conduct an Internal Investigation?

If the allegations relate to conduct and circumstances that could lead to criminal or civil liability, company directors may have a fiduciary duty to conduct an independent internal investigation as shareholders expect the company to act in its best interest. The duty to investigate arises if a director learns of facts suggesting that key executives engaged in fraud or that the company's books or public statements are inaccurate. Equally as important, from a government regulator's point of view, there is an expectation that in the face of claims of misconduct or violations of the law a company will thoroughly investigate the allegations and take appropriate remedial measures if necessary. In the end, initiation of an independent investigation will be viewed by government regulators as good corporate governance and cooperation by government regulators.

Who Should Conduct the Investigation?

Using experienced outside counsel can make a difference in helping a company and its board demonstrate the reliability of conclusions to government regulators, criminal investigators, shareholders and the general public. The professional experience of the counsel in this area is a key component of credibility with regulators. The question that sometimes arises in hiring outside counsel is whether the company can or should use a lawyer or law firm that it typically uses for outside legal work. The answer is: it depends. In using the "go to" law firm the company increases efficiencies because of a decreased learning curve. It will take longer and as a consequence it will be more expensive for an outsider to get to the same place as the firm familiar with the company. Sometimes this is an easy decision if the preferred firm or lawyer was involved or counseled the company on any aspect of the matter leading to the investigation or if key executives under scrutiny have a close relationship or tie to the law firm or one of its lawyers. The higher the potential for the appearance of a conflict of interest the greater the pressure to hire a firm whose independence will be unquestioned. If government regulators disagree or question the findings of the investigation they are less likely to question the motives of the company when an independent outside counsel is engaged.

Does It Matter What You Say to Your Employees?

Employees are not only agents of the company, they are also potential witnesses for or against the company. At some point, regulators may conduct an interview of employees and will ask the witnesses to recount any conversations they have had about the subject matter of the inquiry. Therefore, it is important that the facts recounting what happened during your interview do not demonstrate any conduct that could be viewed as obstructive or biased in one way or the other.

Before conducting an interview of an employee, any documents relevant to the witnesses' potential knowledge and intent should be reviewed with particular attention paid to e-mail messages. Company counsel should inform the witness of what has come to be known as the *Upjohn* warnings so it is clear to the employee that the counsel is conducting the interview as counsel for the company and not the employee.[1] Counsel for the company should neither show allegiance to the company nor encourage certain responses to questions. A witness interview must be viewed as a neutral fact-gathering process.

During the interview the employee should be asked to preserve and submit any relevant documents he has in his possession.[2] This directive should be made even if a "document hold" is in place. The questions asked should be open-ended and should not supply the answer. Counsel must be prepared to answer questions typically asked by witnesses such as "Do I need an attorney?" and "Is what I tell you confidential?" At the outset, encourage the witness to provide truthful responses to your questions. In at least one instance federal prosecutors viewed false statements made by company executives during interviews conducted by company counsel as worthy of indictment of the executives for obstruction of justice.[3] The executives later pleaded guilty to the charges. Do not make any promises of leniency or immunity if misconduct is revealed.

Documents, Records and Electronically Stored Information

As soon as a decision is made to investigate allegations of corporate misconduct immediate steps should be taken to preserve and retain documents. Government regulators will be most interested in steps taken to not only preserve documents but also to protect the documents from intentional and unintentional destruction. Typical government subpoenas will ask about general company document retention policies and the specific processes that were used by the company in the instance under investigation. The failure to preserve documents will arouse suspicion from government regulators and may trigger a claim of obstruction of justice. In addition, the Sarbanes-

Oxley Act added criminal provisions that prohibit the alteration or destruction of documents in relation to or in contemplation of a government investigation.[4]

If all or part of the investigation involves an overseas operation, particularly in the European Union, data collection may implicate foreign data privacy laws designed to protect employee information or other data. If the investigation expands beyond the U.S., counsel should confirm whether a foreign jurisdiction's laws prevent the access, use or transfer of records containing individually identifiable personal data including basic data such as an employee's name. In addition, local labor laws may also impact data collection. It is advisable for counsel to consult with foreign local counsel on these issues.

Disclosure Obligations

For public companies, it is essential that as an internal investigation moves forward and uncovers new facts careful consideration is given to disclosure issues. Claims of untimely disclosure can arise if the company elects to withhold disclosure until the conclusion of the investigation. Internal investigations can take a few days or years to complete. In some instances public disclosure questions may be best addressed to separate disclosure counsel tasked with coordinating with internal investigation counsel.

Direct Interaction With the Regulators

In all contact or interactions with government regulators it is important to respond accurately to any questions or inquiries. False or misleading statements are not only damaging to the credibility of the company; the government could also conclude that a criminal charge is appropriate for providing false information or obstruction of justice. Counsel should remember that dealing with regulators is not similar to general civil litigation. Regulators expect straightforward answers.

Voluntary Disclosure of the Results of an Investigation

At some point the company may be faced with the decision of whether to disclose the results of an internal investigation. In making this assessment, the company must be mindful if there are statutory or contractual obligations that require disclosure. Depending on the nature of the allegations or the industry in which the company operates, there may be tangible benefits available to companies to come forward and disclose. The benefits and risks must be carefully analyzed and evaluated. In addition, the following risk assessments should be considered: (1) whether disclosure should be discussed with disclosure counsel for the company, given the complex array of securities law implicated in a disclosure decision; (2) whether information protected by various legal privileges may need to be disclosed to make the disclosure adequate or complete; and (3) whether disclosure invites and informs potential civil litigants.

With regard to the issue of privilege, much discussion has occurred in recent years concerning what some practitioners and bar associations have come to call the "culture of waiver" that has developed in the legal profession in response to the policies and pressures of regulators that forced companies to waive privileges or face criminal prosecution and severe economic sanctions. In response, we have seen a retreat in these previously harsh positions. It began with the U.S. Sentencing Commission's removal of the issue of privilege and work-product waivers as a potential factor in determining whether a corporation was entitled to leniency in sentencing based on "cooperation" with the government in its investigation. Thereafter, the Department of Justice (the "DOJ"), with pressure from Congress and the organized bar, finally settled on a revision to the U.S. Attorney's Manual authored by former Deputy Attorney General Mark Filip.[5] Under prior DOJ policies, federal prosecutors were allowed to request the disclosure of some information typically protected by the attorney-client privilege or work-product doctrine and then

consider the waiver as a factor determining whether the company would be credited with cooperation. The new policies forbid the request, with two exceptions.

Like the DOJ, the SEC routinely has used privilege waivers as an indicia of cooperation. Shortly after the release of the new DOJ guidelines, the SEC also changed its guidance to SEC lawyers in issuing the SEC's 2008 Enforcement Manual. The revised rules expressly prohibit SEC staff attorneys from asking business organizations to waive the attorney-client and work-product protections. For the SEC, the relevant inquiry is not whether the privilege has been waived, but whether all relevant facts have been disclosed. Still, other regulatory agencies with policies similar to those now barred by the DOJ and the SEC have not come forward with similar revisions.

In the end, how much a company is willing to disclose will be dictated by the law and its overall business strategy. A company must be responsive to a wide array of stakeholders, including government regulators and shareholders and, in that context, it must operate in what is in the best interests of the company.

Compliance Policies and Programs

When bad things happen within a company, government regulators are interested in the compliance programs and policies in place within the company and how effective the program has been in detecting and preventing corruption and misconduct. They will want to know whether the investigation revealed that the detected misconduct was a random act or the unwinding of a significant and systemic problem within a company.

Over the years, government regulators have made clear pronouncements regarding the components of an effective program. A good starting point for developing an understanding of the expectations of regulators is the review of the U.S. Corporate Sentencing Guidelines that have been promulgated by the United States Sentencing Commission. Under these guidelines, to have an effective ethics-and-compliance program an organization must act to prevent crime and promote an organizational culture that encourages lawful behavior.[6] Under these Guidelines, if a company is prosecuted, the severity of the potential penalty can be reduced if an effective compliance program was in place at the time of the misconduct.

Conclusion

Your interactions with government regulators can occur at any stage within the course of an internal investigation. Most of these interactions can be planned ahead of time but, in some instances, they cannot. Counsel should keep in mind the various instances where the government will be seeking information from the company, and work to make these instances proceed in a way that best advances the interests of the company.

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[1] The witness warnings should advise that: (1) counsel represents the company, not the employee; (2) information learned in the interview is privileged to the company and it is the

company's decision whether to waive the privilege and disclose the information to the government or third parties; (3) the contents of the interview are to be kept confidential so the company's privilege can be preserved. Lawyers who elect to "distill" these warnings during an investigation should be wary of the potential consequences. *See In re Grand Jury Subpoena: Under Seal*, 415 F.3d 333, 340 (4th Cir. 2005)(noting that doing so creates a "potential legal and ethical minefield").

[2] An example worth noting involves the federal prosecution of investment banker Frank Quattrone. The indictment alleged: "...Quattrone directed, and caused a subordinate to direct, the destruction of evidence related to the IPOs, he knew of the existence and nature of the regulatory and law-enforcement investigations and knew that CSFB had received subpoenas that required the production of documents relating to the IPOs." *Available at* http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/csfb/usquattrone51203ind.pdf. The indictment also alleged that Quattrone acted "with the intent to obstruct the investigations by the SEC and the grand jury." *Id.*

[3] *See United States v. Silverstein*, No. 1:04-cr-0024-ILG (E.D.N.Y.); *United States v. Rivard*, 1:04-cr-00329-ILG (E.D.N.Y.); *United States v. Kaplan*, No. 1:04-cr-00339-ILG (E.D.N.Y.); *United States v. Zar*, 1:04-cr-00331-ILG (E.D.N.Y.). In these cases the executives were interviewed as part of an internal investigation. After the interviews the corporation waived the privilege and produced to the government memoranda summarizing the interviews.

[4] *See* 18 U.S.C. §§ 1512 and 1519.

[5] *See Principles for Federal Prosecutions of Business Organizations*, *available at* http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm.

[6] U.S.S.G. § 8B2.1.