Ethical Considerations in Internal Investigations

It is easy to forget how critical ethical considerations are in internal investigations because many investigations are not conducted in connection with a court proceeding or government investigation. Rather than giving counsel a sense of complacency, however, it is exactly that lack of formality that opens the door for potential ethical lapses and that merits heightened vigilance. Most lawyers are well versed in ethical canons as they apply to litigation and dealings with the government, but may be less familiar with ethical obligations when handling internal investigations. In investigations, a number of ethical considerations are at play, including, but not limited to, state bar ethics rules, Sarbanes-Oxley, and SEC Rule 102(e). Moreover, counsel must be mindful that courts or regulators may later scrutinize counsel’s conduct during the investigation.

Ethical issues can and do arise at every stage of an internal investigation. Anticipating ethical issues and devising a strategy for handling those situations can minimize risk to the client and bolster the credibility of the investigation. Thoughtful handling of ethical issues lends credibility to the investigative process, yields benefits in efficiency, and creates trust with the regulators.

This outline reviews common issues that arise during investigations and offers tips for avoiding ethical traps.

Document Holds and Retention

**Ethical Issue:** If there is no litigation or government document request, when does a duty to preserve documents arise?

- The duty to preserve documents arises from a variety of sources. See, e.g., Federal Rules of Civil Procedure 26 & 37; Sarbanes-Oxley Act, Section 802, 18 U.S.C. § 1519 (it is a criminal violation to knowingly destroy documents with intent to impede, obstruct, or influence an investigation).

- The question of when the duty arises is not as black and white in an internal investigation as it is in civil litigation or upon receipt of a regulatory subpoena. Not every issue or allegation of misconduct necessitates preservation of relevant documents. If the matter is serious enough to warrant an investigation, the duty is likely triggered.

- Document preservation is an important factor in the company’s ability to secure cooperation credit with prosecutors and regulators.²

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1 Pursuant to SEC Rule of Practice 102(e), the SEC may take disciplinary action against attorneys appearing before the Commission for “unethical or improper professional conduct.” Under the rules promulgated pursuant to Sarbanes-Oxley Section 307, “[a]n attorney retained or directed by an issuer to investigate evidence of a material violation reported under paragraph (b)(1), (b)(3), or (b)(4) of 17 C.F.R. § 205.3 shall be deemed to be appearing and practicing before the Commission.” 17 C.F.R. § 205.3(b)(5).

• As counsel, you have a duty to instruct the client as to its preservation obligations and guide the client through the process. Work with the client to identify document custodians and issue a document hold as soon as possible. If the investigation involves complex electronic data collection, consider engaging an e-discovery/forensic vendor. Self-collection (i.e., where the custodian selects and provides relevant documents/emails) is generally disfavored and, if the custodian may have been involved in the misconduct at issue, is not defensible.

• Bottom Line: You do not want to be in front of a regulator or court explaining why you launched an internal investigation, yet did not preserve documents. While the initial step is to ensure that any misconduct that triggered the investigation has stopped, document preservation is equally important.

Who Decides Whether an Investigation is Necessary?

Ethical Issue: Does management have an actual or perceived conflict in deciding how to handle allegations of wrongdoing?

• The company (with the guidance of counsel) should assess the allegations and make an informed decision as to whether an investigation is needed. But who makes that decision—the general counsel, management, the board, the audit committee, or a special committee of the board?

• Management, in consultation with the general counsel, may be involved in deciding whether to investigate certain allegations, such as isolated wrongdoing by lower-level employees.

• Management must not, however, have the final say in determining whether to pursue an investigation where the investigation’s findings could implicate management. Even if it seems unlikely that management knew of the alleged conduct, management’s decision not to pursue an investigation could later be viewed as improper if it turns out that management had some knowledge of, or involvement with, the underlying conduct. Furthermore, management involvement under such circumstances presents the appearance of a conflict.

• In circumstances where the investigation could touch management, the board (or the audit or special committee of outside directors if inside directors are implicated) should make the decision.

• Best practices dictate that certain types of allegations should be handled by the board, or the board should at least be consulted, particularly those that may be material events with disclosure obligations (e.g., FCPA violations and material financial issues).

• When determining how to respond to allegations, inside and outside counsel must be cognizant of the “up the ladder” reporting requirements of 17 C.F.R. § 205.3, promulgated pursuant to Sarbanes-Oxley Act, Section 307.

Who Conducts the Investigation?

Ethical Issues: If management conducts the investigation, will there be a conflict of interest or an appearance of possible bias given the subject matter of the investigation? If the general counsel’s office or the company’s internal audit group performs the investigation, will they possibly be subject to internal pressures that could impact the investigation’s course or findings?

• After the company decides to initiate an internal investigation, the company must consider who should conduct the investigation—the general counsel, management, the board, the audit committee, or another subset of the board.
• Management, in consultation with the general counsel, should only conduct the investigation if there is no possibility that the allegations could implicate management. If the nature of the investigation does not disqualify management from conducting the investigation, management should consider who to use for the investigative tasks. The possibilities include internal audit, the general counsel’s office, regular outside counsel to the company, regular outside counsel to the board, or independent outside counsel not regularly used by either the company or the board.

• If management is implicated or the allegations are of a serious nature so as to potentially be material, the board, the audit committee, or a special committee of outside directors should conduct the investigation.3

• When the board conducts an investigation, outside counsel should be engaged to perform the investigative tasks. Selecting outside counsel who does not regularly advise the company or the board will help avoid the possibility or appearance of a conflict of interest. The company’s regular outside counsel may lack—or be perceived to lack— independence. Loyalties, fear of losing work, or the desire to obtain additional work from the company, and complicity, can affect regular counsel’s ability to run the investigation. There have been several high-profile examples of prominent law firms’ investigations being questioned over alleged lack of independence (e.g., Enron and Global Crossing).4

• In 2001, the SEC articulated a cooperation framework to analyze whether companies should be afforded cooperation credit in enforcement matters. That report, known as the Seaboard Report, sets forth 13 factors relevant to the SEC’s cooperation determination. In 2010, the SEC launched the Enforcement Cooperation Initiative, which among other things memorialized the Seaboard Report in the SEC Enforcement Manual under Section 6.1.2 titled a “Framework for Evaluating Cooperation by Companies.” Paragraph 10 of the Seaboard Report focuses on the process used during the internal investigation and suggests that the more independent the investigation is (i.e., conducted by outside directors and performed by outside counsel who is not regular counsel to the company) the greater the likelihood that the investigation will be viewed as independent by the SEC, a factor in determining the level of cooperation credit to be accorded to the company.5

3 Sarbanes Oxley Act, Section 301 provides that the audit committee has the “authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.”


Global Crossing retained Simpson Thacher, its regular outside counsel, to conduct an investigation into the company’s Vice President’s allegations of accounting improprieties. Following allegations of a deficient investigation that was possibly influenced by conflicts relating to Simpson Thacher’s significant other work for Global Crossing, Simpson Thacher agreed to a $19.5 million settlement in a securities class action. See Global Crossing Settles, The 10-b-5 Daily, March 22, 2004 (available at http://www.the10b-5daily.com/archives/000314.html).

5 Paragraph 10 of the Seaboard Release on Cooperation, Exchange Act Release No. 44969 (October 23, 2001) provides:

Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior? Did management, the Board or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?
Conducting Interviews

**Ethical Issue:** Is counsel required to take any special precautions when interviewing company employees?

- In the course of most investigations, counsel will interview employees who often will not be represented by counsel. Counsel is obligated to make certain disclosures to employees so that they understand the scope of counsel’s representation.

- ABA Model Rule 1.13(f) and the frequently used Upjohn warning, derived from *Upjohn Co. v. United States*, 449 U.S. 383 (1981), require an attorney representing an organization to ensure the employee understands at the outset that he or she is not a client. The warning should (a) inform the employee that the lawyer represents the corporation and not the employee individually; (b) briefly describe the nature of the investigation; (c) explain that the conversation is protected by the attorney-client privilege, but that any decision to waive privilege will be made by the company, not the employee, and the company reserves the right to disclose the substance of the interview to third parties, including the government without providing any notice to the employee; (d) inform the employee that, with the exception of the employee’s personal attorney, he or she may not discuss the substance of the interview with any third parties, including other employees; and (e) ask the employee if he or she understands and is willing to proceed with the interview.

  - The Upjohn warning should be memorialized in the interview memorandum prepared after the interview. Failure to document the Upjohn warning can lead to serious consequences if the interviewee later claims that he or she was not so advised.\(^7\)

  - If asked, or if an issue arises that necessitates the discussion, explain to the employee that he or she is entitled to independent counsel,\(^8\) although not necessarily at the company’s expense.

- Robert Khuzami, the former director of the SEC’s Division of Enforcement, has cautioned attorneys regarding interviewing multiple witnesses at once, aggressively promoting exculpatory evidence while dismissing clear and identifiable red flags, or scapegoating lower-level employees and/or protecting senior management.\(^9\)

- Outside counsel should also avoid giving management a preview of the topics to be addressed during employee interviews so as to avoid any temptation to coach witnesses.\(^10\)

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\(^6\) ABA Model Rule 1.13(f) states: “In dealing with an organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.” Comment 10 to Rule 1.13, titled “Clarifying the Lawyer’s Role,” further provides:

> There are times when the organization’s interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

\(^7\) See *United States v. Ruehle*, 583 F.3d 600 (9th Cir. 2009) (referring counsel to the California Bar for discipline for failing to document the Upjohn warning allegedly given to the interviewee).

\(^8\) See MODEL RULES OF PROF’L CONDUCT R.1.13 cmt. 11 (“Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.”).


Joint Representation

Ethical Issue: Is it appropriate to represent multiple parties? If so, under what circumstances and how should the representation be structured?

- ABA Model Rule 1.13(g): “A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents subject to the provisions of Rule 1.7.”

- ABA Model Rule 1.7: If no concurrent conflict exists (i.e., directly adverse or the representation would be materially limited by responsibilities to other client[s]), a lawyer may represent multiple parties if the lawyer “reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client ...”

- Each affected client must give informed consent in writing.\(^{11}\)

- Best practices call for disclosure and informed consent in the engagement letter so that it is clear from the outset. The engagement letter should (1) summarize the applicable rules of professional conduct; (2) state that counsel is not currently aware of any conflicts of interest; (3) have the client confirm that the client is also not aware of any conflicts of interest; (4) explain that both counsel and client should immediately inform the other if they believe a conflict has developed; and (5) address what counsel intends to do in the case of a conflict. If counsel intends to continue its representation of the company in the case of a conflict—as is typically the case—make this clear and explain that counsel may use information the conflicted client may have shared during the representation.\(^{12}\)

- Other issues such as privilege and confidentiality concerns may arise in joint representations. Proceed with caution and consider the applicable rules and principles.

- Counsel should also be cognizant of the SEC’s Enforcement Cooperation Initiative as it relates to joint representation. Joint representation is a common practice because it helps to control defense costs, but the SEC has publicly suggested that defense counsel should expect increased scrutiny of joint representation because it can interfere with the Commission’s ability to engage with potential cooperators.\(^{13}\)

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11 See MODEL RULES OF PROF'L CONDUCT R.1.7(b).

12 ABA Model Rule 1.8 prohibits a lawyer from using information relating to the representation of a client to the disadvantage of the client unless the client gives informed consent.

13 In his widely-cited 2011 remarks, Mr. Khuzami focused on joint representation as an area ripe for ethical challenges. Robert S. Khuzami, Remarks to Criminal Law Group of the UJA-Federation of New York, supra, note 7. Speaking on this issue, Mr. Khuzami stated:

   It is worth noting that the SEC’s new Cooperation Program raises the stakes in multiple representation situations. The Program, announced by the Commission in January 2010, provides for reduced sanctions, or even no sanctions, in exchange for truthful and substantial assistance in an SEC investigation.

   This increases the likelihood that one counsel cannot serve the interests of multiple clients, given the real benefits that could result from cooperation, such as one client testifying against another client represented by the same counsel.

   In light of the potential for cooperation, we are taking a closer look at such multiple, seemingly adverse, representations. You will likely see an increase in concerns expressed by SEC staff in those situations.
Duty to Disclose or Withdraw

**Ethical Issues:** Are there circumstances where counsel participating in the investigation must report violations discovered during an internal investigation either to the board or to the government? Are there circumstances where counsel must withdraw from the representation?

- Section 307 of Sarbanes-Oxley Act, and the SEC rules promulgated thereunder, impose upon lawyers appearing and practicing before the SEC a duty to “report evidence of a material violation” of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof). “[I]f the counsel or officer does not appropriately respond to the evidence” the attorney must “report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of [outside] directors . . . or to the board of directors.” This is what is commonly referred to as “up the ladder” reporting.

- But what about reporting violations outside of the company? Sarbanes-Oxley Act, Section 307 and 17 C.F.R. 205.3, provide that an attorney may reveal confidential client information to investigators if the attorney believes that doing so will prevent a violation of the law or help rectify losses investors have already suffered. This is known as a “noisy withdrawal.”

- ABA Model Rule 1.6(b)(2) & (3) (which address confidentiality) provide that a lawyer may reveal confidential client information:
  1. to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer’s services
  2. to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client’s commission of a crime or fraud in furtherance of which the client has used the lawyer’s services

- ABA Model Rule 1.13 pertains to organizations as clients. Rule 1.13(b) & (c) require that in-house counsel report certain conduct to a higher authority at the company and, if necessary, the highest authority within the organization. Conduct must be reported if it is “likely to result in substantial injury to the organization.” ABA Model Rule 1.13(b). Under Rule 1.13, if the highest authority fails to act, and the lawyer “reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure.”

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14 Disclosure is not mandatory. The SEC originally proposed a rule making it mandatory, but after significant opposition elected to adopt a discretionary version of “noisy withdrawal.”

15 Comment 7 to ABA Model Rule 1.6 provides additional helpful information regarding an attorney’s obligations where the client is using the lawyer’s services to commit fraud or a crime:

> Although paragraph (b)(2) does not require the lawyer to reveal the client’s misconduct, the lawyer may not counsel or assist the client in conduct the lawyer knows is criminal or fraudulent. See Rule 1.2(d). See also Rule 1.16 with respect to the lawyer’s obligation or right to withdraw from the representation of the client in such circumstances, and Rule 1.13(c), which permits the lawyer, where the client is an organization, to reveal information relating to the representation in limited circumstances.

16 Comment 8 to ABA Model Rule 1.6 explains that Paragraph (b)(3) does not apply when the client retains the attorney to represent the client in relation to the crime or fraud.
• It is critical to be familiar with the confidentiality/whistleblowing ethical rules of the state where you practice as the ABA Model Rules are exactly that—a model. While many states follow the model, there are various state-by-state nuances even amongst those that have adopted Rule 1.6. However, some states prohibit lawyers from disclosing confidential client information in virtually all situations (even where the ABA Model Rules allow), while, on the other extreme, some actually require outside disclosure in certain circumstances, such as financial fraud.

• SEC Rule 205 states that it preempts state ethical rules when there is a conflict. However, states that do not permit disclosure of client confidences to prevent financial harm (e.g., California) may disagree with this position.

• ABA Model Rule 1.16 specifies the circumstances under which an attorney is either required or permitted to withdraw. An attorney must withdraw under Rule 1.16(a)(1) if “the representation will result in violation of the rules of professional conduct or other law.” An attorney may withdraw under Rule 1.16(b)(2) & (3) if “the client persists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent” or “the client has used the lawyer’s services to perpetrate a crime or fraud.”

Conclusion

Counsel will encounter ethical issues at every stage of the investigation. With careful attention, counsel can avoid ethical pitfalls. To quote SEC Commissioner Glassman, who paraphrased the Greek statesman Pericles, “We do not say that a man who takes no interest in ethics minds his own business; we say that he has no business here at all.”


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