

# B&B REVIEW

## Corporate Investigations Practice Group

### WHEN SHOULD YOUR BUSINESS CONDUCT A SPECIAL INVESTIGATION?

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#### INTRODUCTION

The Corporate Investigations Practice Group of Balch & Bingham has lawyers from multiple practice areas who specialize in conducting corporate investigations. The group's members represent companies, boards, board committees and employees in a wide variety of types of investigations.

This B&B Review discusses why businesses of all types are seeing the need for more internal investigations, what can trigger an investigation and the forms that an investigation can take. Future B&B Reviews will cover such topics as who should conduct an investigation, what to do about documents, what the report or other work product from an investigation should contain and who should receive the report.

#### WHY ARE BUSINESSES SEEING THE NEED FOR MORE INTERNAL INVESTIGATIONS?

The simple answer to why businesses are seeing more need for internal investigations is that they are being subjected to more and more regulation and scrutiny from more and more sources. Just being taxed is a form of regulation and inquiries from an IRS agent can require some significant investigation at times. Some businesses are regulated because of the effect their operations can have on the public, such as financial services companies, companies that have public shareholders, health care providers, food and drug manufacturers and businesses that create environmental hazards. Other businesses are regulated because they do business with the government or are paid by the government. No matter what the source of government oversight, however, the possibility of a violation of laws or regulations can create the need for someone to investigate the facts and apply them to the laws and regulations in question.

Business regulators have become much more aggressive in recent years as a result of well-publicized corporate scandals, and have been joined by law enforcement authorities such as state attorneys general and federal prosecutors. Moreover, there has been a "criminalizing" of some business law violations either by creating new criminal penalties where none existed before or using existing criminal penalties that had been rarely used before. For example, Congress added new criminal penalties in the Sarbanes-Oxley Act in 2002 for knowingly inaccurate financial disclosures by public companies. Similarly, the recent indictment of a public company CEO for backdating stock options when he did not benefit personally also represents a continuing trend toward the use of criminal laws in a business setting.

Criminal law enforcement authorities can also get involved in a business's affairs in ways unrelated to substantive regulation of the business. For example, it is often the federal or state laws relating to theft that are applied when there are allegations of financial improprieties by senior managers of a company, public or private.

The net effect of the increasing web of regulation, increasing number of regulators and increasing risk of criminal prosecution for regulatory violations and other offenses is a dramatic uptick in the need for internal investigations.

#### WHAT CAN TRIGGER AN INTERNAL INVESTIGATION?

There are a variety of events than can trigger the need for some sort of internal investigation:

##### Third Party Complaint or Notice.

Businesses should have monitoring systems in place to determine whether a complaint from an

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outside party such as a customer, vendor or competitor is an isolated incident or a sign of a possible regulatory or other legal violation. If the latter, then an internal investigation might be advisable. Certainly the health care industry is well aware of the “qui tam” actions available to customers and others who believe that the federal government has been overcharged or otherwise defrauded, and “blow the whistle”. Recently, Coca-Cola was alerted by its primary competitor, Pepsi-Cola, to an alleged scheme to steal its trade secrets by a Coke employee.

**Employee Complaint.**

Increasingly, businesses are setting up “hotlines” so that employees can report concerns anonymously. The Sarbanes-Oxley Act requires that there be a mechanism in place for employees to report to their company audit committee concerns over financial disclosures. In addition there are a growing number of laws that protect employees who register complaints of some sort. For example, employees have long been protected against discrimination by their employers for bringing charges of discrimination on the basis of race, gender and other protected classes. In some industries, such as health care, there are regulatory “protocols” that require that businesses self-identify and self-disclose possible regulatory violations, in order to remain eligible for future participation in government programs

**Regulatory Inquiry.**

Sometimes, a seemingly innocuous question from a tax agent, OSHA inspector or other regulator can portend something more serious. Businesses should consult with legal counsel to determine what the appropriate response should be.

**Regulatory Investigation.**

It is almost always advisable for a company to gather information quickly and completely when faced with a formal government investigation, so as to be able to respond effectively. For example, it is entirely possible that your own investigation will show that there was no violation of law. Or, your investigation might help persuade the government to limit the scope of its investigation or to agree to a settlement. Where a federal law applies with criminal penalties, the United States Sentencing Guidelines make it clear that criminal penalties will be reduced if there was “an effective program to prevent and detect violations of law”.

**Private Lawsuit.**

Where a lawsuit has been brought, the case for an internal investigation becomes more

compelling. For example, in a lawsuit alleging sexual harassment, whether a company is subject to punitive damages can depend on whether it conducted a prompt and effective investigation when it was put on notice that an employee may have engaged in the complained-of behavior.

**Where Directors Might be Personally Liable.**

Public company directors are increasingly being held accountable for legal compliance. In Caremark International, Inc. Derivative Litigation, for example, the Delaware court opined that directors should be liable unless they have assured themselves that there are information and other systems in place to provide senior management and the board with information that enables them to reach an informed judgment on the company’s compliance with law. It might be difficult to argue that such a system was in place if the company failed to investigate a material problem promptly and efficiently and report the results upward.

**WHAT FORMS CAN THE INVESTIGATION TAKE?**

**Informal.**

At the most informal level, an investigation might consist simply of a few interviews and the gathering and review of a limited number of documents. Human resource professionals, for example, are skilled at conducting investigations into claims of harassment, and often do not even involve an attorney in the process. No matter how informal, however, the results of an investigation should be reported to the appropriate manager and acted upon if there is some finding of wrongdoing.

**More Formal.**

Where an informal investigation reveals potentially serious problems or where the allegations in an employee or customer complaint are sufficiently serious, then a company is well-advised to undertake a more formal process for investigating the matter. Here is where involving an attorney may be crucial not only to utilize his or her experience in conducting investigations but also potentially to protect certain information from further disclosure because of the attorney-client privilege or attorney work product doctrine. However, these protections are coming under attack in the corporate setting. Indeed, it is now common practice for a company to waive the attorney-client privilege in situations in which there might be criminal prosecution, in order to demonstrate the company’s cooperation with prosecutors.

### **Most Formal.**

In the most formal investigations, there is always experienced legal counsel involved who manages the investigation process. In these investigations, there may be far-reaching searches for documents, electronic and paper, and many interviews of witnesses. An orderly process with careful record keeping will be crucial to the success of the investigation. For example, counsel will advise immediately that a "document freeze" communication be issued that identifies documents that should be preserved and where to send them. If the company has any sort of document destruction process, for paper or electronic documents, legal counsel will seek out the right people in the company to make sure that the destruction ceases. In most cases a factual chronology will be prepared by legal counsel with references to interviews and documents. Counsel will advise whether and how much of the results of the investigation to share with third parties.

### **Special Note on Separate Counsel**

For public companies subject to Sarbanes-Oxley, that law requires that audit committees have access to their own legal counsel separate from the company's counsel. Independent legal counsel may also be advisable when there is some involvement in the matter under investigation by senior management, when a regulatory agency is involved or when the usual company counsel might have had some involvement in the matter. It may be advisable, too, for there to be separate counsel for the individuals involved if their interests might be adverse to the company's.

### **CONCLUSION**

It is important to keep in mind that most investigations are relatively informal and inexpensive and are not a prelude to a government regulatory action or private lawsuit. Nonetheless, businesses should recognize when an investigation might be necessary to manage a potential legal risk and to engage the right professionals to conduct the investigation.

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