ETHICAL AND PRACTICAL CONSIDERATIONS WHEN CONDUCTING INTERNAL INVESTIGATIONS

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When corporate counsel learns a criminal violation possibly occurred within the entity, counsel may be required to conduct an internal investigation to properly advise the client on critical matters.

In carrying out an internal investigation, counsel faces challenging ethical, legal and tactical decisions that may have significant impact on the corporation's ability to conduct business.

Timing of Investigation and Interviews

When counsel learns of potential wrongdoing, a comprehensive internal investigation should occur at the earliest opportunity. Counsel will need to make speedy decisions regarding conflicts, joint defense agreements, voluntary disclosures to the government, waivers of attorney client privilege and work product and statements to the media. The groundwork for such decisions is often made with limited knowledge and in an emergency context. As explained below, there are numerous incentives for voluntary disclosure of misconduct incorporated into federal regulations and statutes.

Whose Lawyer Are You?

"An attorney who represents an entity such as a corporation or partnership generally represents that entity only and not its employees, shareholders or owners." Oregon State Bar Formal Ethics Opinion, 1991-85. However, where counsel tells the shareholders or owners that they are individual clients, or otherwise leads them to believe that they are also the attorney's clients, they will be held as such. *Id.* In order to avoid this potential hazard in conducting the internal investigation, corporate counsel must make clear with the corporate employees contacted that he or she represents the entity and not the individual employee.

The test for determining whether attorney client relationship exists is set out in *In re Weidner*, 310 Or 757 (1990). The elements of the test includes the following (1) whether services performed by the lawyer were the kind traditionally done professionally be lawyers, *i.e.*, legal work; and (2) whether the putative client intended that the relationship be created. *Id.* at 768. The Oregon Supreme Court has made clear that the existence of the attorney client relationship turns on the subjective intent of the would-be client. *In re Conduct of O'Byrne*, 298 Or 535 (1985). Thus, an attorney-client relationship could be inadvertently created if corporate counsel is not careful in making his or her role clear to the subjects of the internal investigation.

At the heart of this issue is the ethical obligation to avoid circumstances where an attorney is representing one person whose interests are in conflict with another client.

See DR 5-105. The difficulty for corporate counsel is that one typically does not know whose interests are in conflict until a point well into the investigation. As discussed below, this conflict is inherent under the Federal Sentencing guidelines that establish criteria for corporate leniency at the cost of turning in and assisting in the prosecution of key corporate employees.

Another ethical element at play when counsel meets with corporate employees is the prohibition from giving legal advice to unrepresented parties, other than the advice to secure counsel, if the interests of the person are or have a reasonable possibility of being in conflict with the interests of the corporate client. *See* DR 7-104(A)(2).

When counsel is interviewing unrepresented employees, it is always good practice to (i) advise the employee of exactly whom counsel represents, (ii) inform the employee that her statements are not confidential, that the corporation has sole discretion as to the use of their statements, and (iii) tell the employee that it is up her to decide whether to make a statement or not.

Corporate counsel should also be aware that as a condition for obtaining the full benefit of a voluntary disclosure, the Justice Department, the SEC and other agencies often require waivers of (i) attorney client privilege and work product protection as it applies to witness interviews, (ii) communications between counsel and the corporate client, and (iii) communications between employees of the corporation regarding the investigation. Further, it should be noted, that when the government is evaluating a corporation's level of cooperation, it considers the decision to hire separate counsel for purposes of protecting a perceived culpable employee and the decision to share information through a joint defense agreement to be factors that count against the notion of full cooperation. (*See Thompson Memorandum*, January 200 2003 referred to below and attached to these materials).

Separate Counsel

Because of the obligation to avoid conflicts of interests, corporate counsel would be well advised to seek out separate counsel to represent individuals or groups of employees. During the course of internal investigations, employees often ask questions that call for legal advice about whether they should admit what really happened and whether they should speak with investigators from government agencies. As noted above, if corporate counsel puts herself in a position where she is giving legal advice to different members of the corporation, there may be serious ethical ramifications should it later turn out that any of those individuals have interests that are adverse to the corporation or each other. Therefore, it is prudent for corporate counsel to advise individual employees to obtain separate counsel, or alternatively, provide separate counsel for those employees at an early stage in the investigation to avoid the chance of a conflict later.

A possible consequence of having separate counsel, however, is that such an employee may refuse to make a statement to corporate counsel after consulting with her

individual attorney, and may thus hinder the corporate counsel's ability to obtain information necessary to protect the company's interests. Conversely, the involvement of separate counsel may also enhance the ability of the corporation's attorney to gather data, assess the situation, and take action on behalf of the company.

Joint Defense Agreements

In circumstances where potential conflicts make separate counsel necessary or desirable, a carefully crafted joint defense agreement can maximize the sharing of information between the parties without creating the potential conflicts inherent in joint representation. The joint defense agreement has historically been viewed as an extension the attorney-client relationship protecting communications between clients and counsel to the degree they share common interests and where such communications are intended to facilitate effective representation. *Continental Oil Co. v. United States*, 330 F. 2d 347 (9th Cir. 1964).

The application of the joint defense privilege is viewed as an exception to the requirement that for communications to be protected under attorney-client privilege, they had to be made in confidence between attorney and client. In one of the earliest American cases applying the rule, the Supreme Court of Virginia held that defendants who were under joint indictments and who met with their attorneys for the purposes of planning for a joint defense had the power to prevent one of the attorneys from testifying regarding the communications that took place between them. *Chahoon v. Commonwealth*, 62 Va 822 (1871).

The joint defense privilege is well-recognized within the Ninth Circuit and elsewhere. *See, e.g. Hunydee v. United States*, 355 F.2d 183 (9th Cir. 1965); *Waller v. Financial Corp. of Am.*, 828 F.2d 579, 583 n.7 (9th Cir. 1987); *United States v. Henke*, 222 F3d 633 (9th Cir 2000); *In re Santa Fe Intern. Corp.*, 272 F.3d 705, 719 (5th Cir 2001); *United States v. Evans*, 113 F.3d 1457, 1467 (7th Cir 1997); *United States v. Aramony*, 88 F.3d 1369, 1392 (4th Cir. 1996); *United States v. Schwimmer*, 892 F. 2d 237, 243 (2nd Cir. 1989).

The privilege is applicable not only in criminal cases, but in civil and administrative matters as well. *Western Fuels Asso. v. Burlington N. R. Co.*, 102 F.R.D. 201, 203 (D. Wyo. 1984) (civil codefendants); *In re LTV Secur. Litig.*, 89 F.R.D. 595 (N.D. Tex 1981) (administrative proceedings). The privilege is equally applicable both before and after an indictment has issued. *Continental Oil v. United States*, 330 F. 2d 347, 350 (9th Cir. 1964).

Complete commonality of interests is not required for protection of the joint defense privilege; however, the protection sought must involve a common purpose related to the parties' defense, even though their interests are not compatible in all respects. *United States v. McPartlin*, 595 F.2d 1321 (7th Cir 1979). The rule does not apply when there is no common interest to be promoted by a joint consultation of the parties. *Id.* at 1336. Caution on this issue is appropriate, however, as courts have

occasionally cast doubt as to whether the statements of employee participants in a joint defense agreement to attorneys representing the corporation were meant to further a common purpose of both the corporation and the employees. *United States v. Kepliner*, 776 F.2d 678, 701 (7th Cir. 1985). Thus the opportunity exists for a finding that no joint defense privilege applied in circumstances such as meetings with officers together with low level employees where the common interest as defined by having similar power or control for decision making within the corporation is not present.

In addition to confidential communications between parties with common interests, the joint defense privilege has also been extended to shared work product. *Haines v. Liggett Group, Inc*, 975 F.2d 81 (3rd Cir. 1992), *United States v. AT&T*, 642 F.2d 1285 (D.C. Cir 1990).

It is well established that a joint defense agreement cannot be waived without the consent of all parties to the privilege. *In re Grand Jury Subpoenas, 89-3 and 89-4, John Doe 89-129*, 902 F.2d 244, 248 (4th Cir. 1990). Most joint defense agreements are structured so as to ensure that no privileged information obtained from one member to the agreement can later be used against another member. In *United States v. Henke*, 222 F.3d 633 (9th Cir. 2000), the court reaffirmed the principal that privileged information obtained in the course of a joint defense meeting must remain confidential. *Henke* involved three co-defendants who participated in joint defense meetings where confidential information was discussed concerning their knowledge of the conspiracy to falsely report revenue. *Id.* at 636-37. One of the three defendants accepted a plea and became a government witness. The other defendants anticipated that his testimony would conflict with statements he had made in the course of joint defense meetings. Counsel for one of the remaining defendants then moved to withdraw because it placed him in the untenable position of having to choose between zealously representing the client by cross examining the testifying co-defendant with information that was the obtained under the joint defense privilege, or maintaining the confidentiality of the privileged information as required by the applicable rules of ethics and the joint defense agreement at the expense of the client.

The trial court denied counsel's request to withdraw. Counsel conducted no cross examination of the testifying witness out of fear that it would lead to inquiries into material covered by the joint defense privilege. *Id.* at 637. The Ninth Circuit held that the trial court erred in not acknowledging the conflict. *Id.* at 638. The Court firmly stated that it was not saying that joint defense meetings are, in and of themselves, disqualifying. It noted that there would be circumstances information about a former co-defendant learned in the course of a joint defense agreement would not breach counsel's duty of confidentiality. *Id.*

The Ninth Circuit has suggested that a party to a joint defense agreement has the right to ask the court for injunctive relief or disqualification of counsel as provided in the agreement if the party believes that a disclosure is about to be made in violation of the agreement. *Waller v. Financial Corp.*, 828 F.2d 579, 584 (9th Cir. 1987).

Notwithstanding its relatively universal acceptance, the joint defense privilege is the source of some divergent opinions. For example, two recent cases cast doubt on whether joint defense material can remain cloaked in confidentiality in certain circumstances. In *United States v. Stepney*, 246 F. Supp. 2d 1069, (N.D. Cal. 2003), the district court ordered the parties to provide copies of their joint defense agreements *in camera*, and further ordered that the agreements had to include a limited waiver of confidentiality if any of the members later decided to testify. The *Stepney* outcome appears to be a result of its unusual posture and unique facts. Nearly thirty defendants were charged with gang-related drug and weapons offenses, and some of them sought to share information with each other. *Id.* at 1071-72. At an initial appearance, the court ordered that any joint defense agreements be in writing and submitted to the court *ex parte*. No agreements were ever filed, but a year later one of the attorneys moved to withdraw claiming a duty of loyalty had been created with another defendant who had since become a government witness. The attorney did not believe he had obtained any confidential information from the cooperating defendant, but felt that the joint defense agreement had created an implied attorney-client relationship. *Id.* at 1072. The trial court denied the motion to withdraw, concluding that no general duty of loyalty is implied from a joint defense relationship.

While *Stepney* did recognize that joint defense agreements "impose an ethical duty of confidentiality on participating attorneys," the court went out of its way to express its belief that the interests of any two of the defendants were unlikely to coincide other than in that particular case. *Id.* at 1077-78. The trial judge found that owing to the large number of defendants, the variety of incidents, and varying degrees of alleged culpability, the case was likely to lead to conflicts of interest that might result in disqualification of defense attorneys late in the proceedings. *Id.* at 1078. Thus, the court ordered that any of the defendants entering into joint defense agreements would be required to waive any duty of confidentiality for purposes of cross examining any testifying defendants. The authority the court cited for this order was its inherent supervisory authority, its constitutional obligation to explore potential conflicts of interest to ensure a defendant's Sixth Amendment rights are adequately protected, and the statutorily mandated inquiry into potential conflicts in instances of multiple representation under Federal Rule of Criminal Procedure 44(c)(2). *Id.* 1077-78. The district court's order in this case was not appealed.

The other troubling case on this issue is *United States v. Almeida*, 341 F.3d 1318 (11th Cir. 2003), in which one of the two parties to a joint defense agreement in a drug conspiracy case decided to cooperate with the government. There, the prosecutor urged the court to prohibit the remaining defendant's counsel from cross examining the testifying defendant with information obtained in the course of the joint defense privilege. The trial court agreed with the prosecutor assertion of privilege on behalf of the government witness, and the defendant was convicted. The Eleventh Circuit vacated the conviction on the grounds that defendant was denied his Sixth Amendment right to have counsel untainted by conflicts. *Id.* at 1323. The court held that the testifying defendant waived the benefit of the joint defense privilege when he decided to testify on behalf of the government in exchange for a reduced sentence. Its holding relied on the

principal, cited from a 150 year old Michigan case, that where an accomplice turns state's witness and attempts to convict others by testimony that also incriminates himself, he thereby waives the privilege against disclosing communications between himself and counsel. *Id.* at 1325.

Stepney and *Almeida* suggest that in some situations the court may actually imply a waiver of the joint defense privilege, even where the agreement of the parties includes a no-waiver provision by which the client acknowledges that she or he runs the risk of having their attorney disqualified because of the inability to use privileged joint defense material in cross examination. This issue raises possible implications for counsel seeking to prevent privileged information from being disclosed by a former joint defense member who turns into a government witness and who thus may have an incentive to disclose information learned from other members either in debriefing the government or in their testimony. Nothing in these cases, however, suggests that a joint defense member cannot seek injunctive relief to enforce the terms of the agreement in such circumstances.

Consequences of Inaccurate Disclosures

Another potential snare for corporate counsel lies in the crime-fraud exception to attorney client privilege. This issue arises in the cases where counsel for the corporation is provided false information in the course of the internal investigation, and such information is used in counsel's presentation to the government to obtain a benefit for the client. When the underlying information is shown to be false, the government may argue that the crime-fraud exception extinguishes any privilege between the attorney and the corporation, thus leaving all of counsel's interviews with the members of the corporate entity unprotected. Under this doctrine, the privilege is pierced where it is shown that the communications were in furtherance of an intended or present illegality, and that there is some relationship between the communication and the illegality. *In re Grand Jury Proceedings*, 87 F3d 377 (9th Cir 1996). It is the client's intentions that are at issue, thus the privilege may be broken in circumstances were counsel is not aware of the illegality involved. *Id.* at 381-82. The government need not even prove that the communications helped the targets commit the crime. *Id.* at 382.

In addition to losing the protection of attorney client privilege, counsel runs the risk of criminal prosecution if the attorney provides inaccurate information to others or otherwise acts in a way from which a culpable *mens rea* may be inferred. The government may assume in such circumstances that counsel is acting with the intent to defraud, even if the reality is that counsel was unaware or only negligent in providing inaccurate information.

United States v. Beckner, provides a cautionary and sobering example 134 F3d 714 (5th Cir 1998). Beckner, a former U.S. Attorney, represented a client under investigation by the SEC for fraudulently soliciting investments to fund a development. Beckner opposed an SEC motion to appoint a receiver and asserted his client's Fifth Amendment privilege in declining to produce certain demanded documents. *Id.* at 715-16. After learning his client was continuing to engage in criminal activity with respect to

the investment scheme, Beckner urged the client to reform his business practices. The client did not follow counsel's advice and Beckner withdrew. *Id.* at 717. However, Beckner was subsequently charged with obstruction of justice based on withholding information from the grand jury and with aiding and abetting in his client's criminal scheme to defraud investors. One of the counts was based on a claimed misrepresentation that Beckner made in a statement to a reporter concerning the nature of the investments. *Id.* at 717-18. The Fifth circuit reversed Beckner's convictions, holding that the government offered insufficient proof of Beckner's knowledge. *Id.* at 718. Ironically, what saved Beckner on the aiding and abetting charge related to the statement to a reporter was evidence that he was actually misquoted in the newspaper. *Id.* at 721. While unwitting assistance in a client's criminal fraud could not sustain the conviction, even an eventual vindication such as Beckner's would come at an enormous professional and emotional cost.

Voluntary Disclosures

When assessing the data obtained in an internal investigation, counsel must have a view toward the possibility of voluntary disclosure to the government. The question of whether the corporation will submit a voluntary disclosure is critically important for several reasons. First, if you complete an investigation before the government is aware of any potential violation. You may under certain agency rules be able to stop an indictment of your client altogether. Your client's reputation may also benefit by generating good will for coming forward without the threat of prosecution.

Under the federal sentencing guidelines themselves, mitigation is available as a result of cooperation and voluntary disclosure. On the other hand, the guidelines also provide for increased seriousness levels, and thus penalties, where there is evidence that the corporate management encouraged or tolerated illegal conduct. USSG §8C2.5(b). Further penalty enhancements exist for cases where the organization willfully impedes or attempts to impede the investigation. USSG §8C2.5(e). The guidelines provide for significant reductions in seriousness level if the organization self-reports the offense, as well as in cases where the organization fully cooperates in the investigation and where there is affirmative acceptance of criminal responsibility. USSG §8C2.5(g). To qualify for such reductions, cooperation must be timely and thorough – this often, but not always, requires the company to provide enough information so that law enforcement can identify the culpable individual(s) within the entity. *Id.* at Application Note 12. There are also downward adjustments if the offense occurred despite an effective program to prevent and detect violations of law. USSG §8C2.5(f).

As an aside, Sarbanes-Oxley may affect compliance programs. On October 22, 2002, the SEC issued Rule Proposals, which, if adopted, would effectively require the certifying officers to design, establish, maintain, evaluate, and report on the corporation's internal controls and procedures for financial reporting. This is defined in the proposal as "a process effected by an entity's board of directors, management and other personnel. . .regarding compliance with applicable laws and regulations." If this proposal is adopted.

compliance programs will not only be an issue for those public companies seeking mitigation, they will be legally mandated.

Another benefit of voluntary disclosure is that if counsel knows what caused the problem, counsel is in a position to help the client create the compliance programs necessary to prevent future reoccurrences. The risk of creating a compliance program is that if the corporation does not live up to it, it can later be used as a roadmap for future prosecution.

A noteworthy problem with the decision to make a voluntary disclosure is that when counsel turns over privileged information to the government, the corporation no longer has control of that data. Thus, material provided to the government as part of a voluntary disclosure waives attorney client privilege as to that material. *In re Worlds of Wonder* 147 F.R.D. 208 (N.D. Cal 1992), see also *Weil v. Investment/Indicators, Research & Management*, 647 F.2d 18, 24 (9th Cir.1981). The *Worlds of Wonder* principle that voluntary disclosure to an investigating government agency waives the privilege as to all other adversaries was reaffirmed in *United States v. Family Practice Associates of San Diego*, 162 F.R.D. 624 (S.D. Cal 1995).

A different, but equally challenging situation is where counsel advises the corporate client of the discovery of criminal conduct within the organization and recommends a voluntary disclosure only to be only to be met with corporate management's refusal to disclose. If the conduct discovered by counsel was historical in context and the organization refuses to proceed with a self-disclosure, counsel's ethical obligation to preserve the confidences and secrets of the client under DR 4-101 preclude any further action. However, if the attorney believes that the criminal conduct is ongoing, and the corporate client still refuses to disclose, counsel's only remedy would be to resign.

Privileged Nature of the Internal Audit

Counsel's analysis and work product obtained during an internal investigation is protected by the attorney-client privilege and work product doctrine. *See* O.R.S. 40.225/OEC Rule 503 for Lawyer-Client Privilege. *See also State ex rel OHSU v. Hass*, 325 Or 492 (1997). If the client decides to disclose material related to the internal investigation to the government in an attempt to gain leniency or in compliance with a statutory duty, such a disclosure may constitute a waiver of any privilege that the investigation once had.

In Oregon, the statute regulating environmental quality creates a limited privilege for an internal environmental audit that is independent of the attorney-client privilege. O.R.S. 498.963(1) states that in order to encourage compliance with environmental regulations, a privilege is recognized in any civil or administrative proceeding protecting the confidentiality of communications relating to a voluntary internal environmental audit. Notably, however, the statue does not apply to a criminal investigation or proceeding. O.R.S. 498.962(2). It also creates a means by which a prosecutor may

obtain an environmental audit report which is asserted to be privileged, along with a process for *in camera* review by the court to determine if the privilege applies.

Notwithstanding the existence of privileges to protect the contents of an internal investigation, the United States Department of Justice issued a memo in January 2003 outlining certain principles concerning prosecution of business entities. The memo directs prosecutors who are gauging the adequacy of an organization's cooperation to consider whether the corporation is willing to waive both attorney-client and work product protections with respect to its internal investigation and to communications between officers, directors, employees and counsel. *Memorandum from Larry D. Thompson*, Deputy Attorney General, to the Heads of Department Components and United States Attorneys (Jan. 20, 2003) as found at http://www.usdoj.gov\dag\cftf \corporate_guidelines.htm. Thus, in order to obtain a declination of prosecution, there may be circumstances when counsel is required to waive any privilege related to the internal investigation and advice given to the corporation concerning the conduct at issue.

Conclusion

There are significant incentives for a corporation to conduct an internal investigation when it learns or suspects criminal wrongdoing from within. There are also legal doctrines that may destroy the privileged status of the information obtained by counsel. Additionally, ethical issues often make performing the internal investigation a complicated task. None of these challenges should deter a thorough internal factual audit when criminal conduct is suspected. This information is needed so that the entity can decide whether to make early use of voluntary disclosure provisions found in the various statutory schemes, or where appropriate, to marshal an all-out factual or legal defense.