Take Proper Precautions

Legal Malpractice Claims Resulting from Internal Investigations

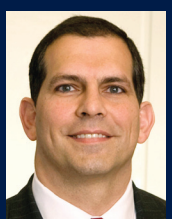
By William C. Wagner and Trent J. Sandifur

Failing to confront common pitfalls appropriately can result in claims for professional malpractice, breach of contract, breach of fiduciary duty, negligent misrepresentation, and aiding and abetting in the purported misconduct.

When an appellate court recently reinstated a $500 million-plus legal malpractice action resulting from the alleged mishandling of a corporate internal investigation by K&L Gates, one of the 10 largest U.S. law firms, lawyers who represent corporations and those who conduct internal investigations took notice. *Kirschner v. K & L Gates LLP*, 46 A.3d 737 (Pa. Super. Ct. 2012). Failing to confront common internal investigation pitfalls appropriately can result in claims against lawyers for professional malpractice, breach of contract, breach of fiduciary duty, negligent misrepresentation, and aiding and abetting in the purported misconduct. Lawyers can also find themselves defending claims brought by the accused employees who lose their jobs as a result of investigations, such as defamation and tortious interference with contractual relations related to their employment. For these reasons, in-house counsel, corporate lawyers, and defense lawyers should understand certain common pitfalls and precautions to take in internal investigations.

Internal Investigations and How They Arise

The purposes of an internal investigation are to conduct a factual investigation into alleged misconduct or questioned practices, to determine whether a corporation violated certain laws or regulations, and to decide which remedies should take place when misconduct has occurred, including whether to self-report to minimize the punishment or damages that a client may have to endure. For example, both state and federal law may make corporations that self-disclose violations discovered during environmental self-audits eligible for immunity from fines and penalties. Environmental Protection Agency Incentives for Self-Policing: Discovery, Disclosure, Correction, and Prevention of Violations, 65 Fed. Reg. 19,168 (Apr. 11, 2000). Investigations by prosecutors, government agencies, or self-regulatory organizations often follow major internal investigations or they happen parallel to these internal investigations. The U.S. Department of Justice, the U.S. Securities and Exchange Commission, the Office of Inspector General, the



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U.S. Environmental Protection Agency, or self-regulatory organizations such as the Financial Industry Regulatory Authority can mount their own investigations. And, as explained below, because corporations have incentives to self-report and disclose investigation findings, these corporations and the lawyers conducting internal investigations should anticipate that they may have to disclose all the uncovered facts, witness interview summaries, and documents created in the internal investigations to prosecutors, the government, regulators, or class action lawyers, and that they may appear as front-page news.

One of the main goals of an internal investigation is to assess the facts and law credibly and independently to determine whether wrongdoing has occurred.

The need for an internal investigation often arises in one or more of the following ways: a complaint from a whistleblower alleging improper or illegal conduct on the part of officers or employees of a corporation; a complaint from a customer, vendor, or competitor concerning pricing or antitrust violations; or an inquiry from a government investigator, news reporter, or public watchdog group. Internal investigations also arise in more formal ways, such as a request for an investigation from a director or officer of a corporation, an internal or external auditor, or compliance officer concerning questionable transactions or accounting practices. Internal investigations have also followed a shareholder demand in the form of a derivative lawsuit, the execution of a federal grand jury subpoena or search warrant, the receipt of a subpoena in a civil case, an informal request for information from a government or self-regulatory organization, or the "reporting up the ladder" Sarbanes-Oxley Act of 2002 requirement.

Certain laws require corporations to conduct internal investigations. For example, section 10A of the Exchange Act requires external auditors who detect or otherwise become aware that an illegal act has or may have occurred to investigate to determine whether an illegal act has occurred and the effect of the illegal act on a corporation's financial statements. Likewise, under the Federal Acquisition Regulation (FAR) mandatory disclosure rule, 73 Fed. Reg. 67,062 (Nov. 12, 2008), federal government contractors are required to make a timely disclosure, in writing, to the Office of the Inspector General, sending a copy to the contracting officer, whenever, in connection with an award, performance, or closeout of a contract or subcontract that the contractor has credible evidence that a principal, employee, agent, or subcontractor has violated federal criminal laws involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code or violated the civil False Claims Act, 31 U.S.C. §§3729–3733. Federal Acquisition Regulation (FAR), Part 52.203-13(a)(3)(i)(A)–(B). These mandatory disclosure rules apply when a contractor provides $5 million or more of services or products to the government under a contract that takes 120 days or more to fulfill, although the Anti-Kickback Act and False Claims Act apply regardless of the amount at issue or the term of the contract. While "full cooperation" under the FAR mandatory disclosure rule does not require a contractor to waive its attorney-client privilege or protections afforded by the attorney work product doctrine, or an officer, director, owner, or employee of a contractor from waiving his or her attorney-client privilege or Fifth Amendment rights, Federal Acquisition Regulation, Part 52.201-13(a)(2)–(3), "full cooperation" means disclosure to the government sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct, Federal Acquisition Regulation, Part 52.203-13(a)(1). Furthermore, full cooperation does not restrict a contractor from conducting an internal investigation. Federal Acquisition Regulation, Part 52.203-13(a)(3)(i). The hammer under the Federal Acquisition Regulation mandatory disclosure rule is the suspension or debarment of a contractor for a knowing failure by a principal of the government contractor to timely disclose credible evidence of a covered violation or significant overpayment for a period of three years after final payment, and it requires reports of violations that occurred before the effective date of the rule.

Common Pitfalls and Precautions

Making good decisions about who should lead an investigation, whether or how to limit the scope of the investigation, how to gather facts to preserve a corporation's attorney-client privilege and work product protection, and how to communicate with employees during an investigation, among other things, can minimize the common pitfalls involved in conducting an internal investigation.

Deciding Who Should Lead an Investigation

One of the main goals of an internal investigation is to assess the facts and law credibly and independently to determine whether wrongdoing has occurred. The first decision is who should lead an investigation. Some possibilities include senior management, in-house counsel, the board of directors, an audit committee, or a special committee of disinterested directors. Prosecutors and regulatory agencies will have a dim view of an internal investigation if the directors or officers alleged to have participated in the wrongdoing also direct the investigation, receive ongoing reports of the investigation, or participate in reaching a conclusion that wrongdoing has not occurred or otherwise minimizes what has happened. If the allegations are serious, credible, and pertain to the conduct of certain directors or officers of a corporation, the corporation should consider forming a special committee of disinterested directors to lead an investigation rather than simply rely on the board of directors as a whole. Likewise, if directors who are under investigation receive investigation briefings, they should happen only when the entire board is assembled, and the corporation should not allow the directors' personal lawyers to attend the meetings. If prosecutors or regulators believe that an internal investigation lacks credibility and independence, they will view it as valueless

and may request that the corporation reinvestigate, which potentially may lead to a malpractice claim.

If a corporation forms a special committee to investigate allegations, a corporate resolution should establish the special committee, identify its purpose, and provide resources to hire lawyers and appropriate consultants, such as auditors or environmental consultants, and to fulfill the special committee's duties properly. Likewise, the lawyers' engagement letter should identify the client with specificity, for example as "the Special Committee of the Board of Directors of XYZ Corporation," rather than just the corporation or its board of directors.

Deciding Whether to Retain Independent Lawyers

Another decision is whether a corporation's regular outside counsel should lead an investigation or whether lawyers who do not have a previous relationship with the corporation should investigate. From a corporation's perspective, it may have a longstanding relationship with its regular outside counsel who may know the business inside-out and the personalities of the key directors and officers in charge. Some corporations simply do not want to pay "strangers" to get up to speed on their business practices. However, prosecutors and regulators again take a dim view of internal investigations performed by a corporation's regular counsel, especially when the allegations involve the regular counsel's previous legal advice or when the regular counsel might be viewed as beholden to the directors or officers under investigation because of their business relationship or long, personal relationships with the directors or officers under investigation. If the allegations are serious and involve directors, officers, or senior management, a corporation should weigh heavily the benefits of using independent counsel rather than the corporation's regular counsel to conduct an internal investigation.

If a corporation decides to retain an independent law firm to conduct an internal investigation and not the regular counsel, the corporation must carefully select the lead lawyers to conduct the investigation. The lead lawyers should have experience with internal investigations and the specific practice area under investigation. Selecting an experienced criminal defense attorney also helps. For example, if an investigation pertains to whether a corporation violated certain environmental laws, the prosecutors and regulatory agencies will look favorably upon a report from an independent lawyer with the requisite knowledge and experience. Lawyers pursuing professional malpractice cases often attack the credibility of an internal investigation if the lead lawyers are dabblers working outside of their regular areas of practice who might not understand the nuances of certain regulatory schemes very well.

Determining the Scope of an Investigation

The lawyers conducting an internal investigation must have sufficient independence to investigate the allegations properly. Prosecutors have become intolerant of internal investigations that limit the scope. They view limitations more often as a red flag rather than as reflecting a corporation's legitimate concerns about costs and managing an investigation.

For example, in *Kirschner*, the plaintiff bankruptcy trustee alleged that K&L Gates engaged in malpractice by limiting the scope of its internal investigation improperly to a number of discrete transactions even though the charge of the special committee of independent directors was to conduct an internal investigation broadly into the circumstances underlying the resignation of senior financial managers. The senior financial managers, including the corporation's chief financial officer, chief administrative officer, vice president of administration, and a senior auditor, all resigned after expressing serious concerns about "unusual" transactions and accounting practices. In addition, the bankruptcy trustee alleged that K&L Gates engaged in malpractice by allowing a central figure involved in the alleged wrongdoing, the corporation's founder, to control the documents produced in the investigation, to control the process for interviewing witnesses, including prohibiting follow-up interviews, and deferring to the founder's uncorroborated explanations for purported improper activities. Each of these alleged circumstances undermined the independence and credibility of the internal investigation.

In *Kirschner*, the engagement letter might have explained more definitively what K&L Gates intended the firm to investigate and also have directed the special committee to expand the investigation as it deemed appropriate. Specifically, the engagement letter might have stated that the firm was retained "to investigate an allegation that the corporation engaged in illegal accounting practices related to certain transactions surrounding bulk tea sold in tankers and possible unlawful collusion between the corporation and certain suppliers, vendors, and customers," the language used by the senior financial managers in their resignation, "*and any other matters that emerge during the investigation which the Special Committee deems warrant investigation*." The special committee could then have decided whether to investigate further to fulfill its fiduciary duty to the corporation and board of directors.

While the scope of an internal investigation must be broad enough to address the allegations fully, a broad scope should not permit outside counsel and forensic accountants to endlessly fish. Foreign Corrupt Practices Act-related internal investigations often require comprehensive but balanced approaches: companies investigating alleged bribes to foreign officials must ask the "where else" question. For example, if a company distributor paid a bribe to a foreign official in Mexico, should the company also investigate whether distributors in other countries also routinely pay bribes? The answer, of course, to the "where else" question is highly fact-dependent. In the Mexico example, a bribe could have resulted from a loose cannon or a systemic problem, such as enforcement agency involvement. But the "where else" question is a primary reason that Foreign Corrupt Practices Act investigations can become very expensive.

Gathering Facts

Fact gathering has various aspects. The process generally includes notifying employees about an investigation, interviewing employees, and dealing with questions during the interviews. A host of concerns lurk behind potential malpractice claims during an investigation fact-gathering process.

Notifying Employees About an Internal Investigation

Before gathering facts a corporation will

want to decide what to say about an internal investigation and which employees to tell. Many practitioners suggest that a corporation send a notice about an investigation only on a need-to-know basis. However, when the news of purported wrongdoing has spread throughout the ranks and morale is at stake concerning longstanding practices or senior employees, a corporation may need to send a notice more widely. On the other hand, news of an internal investigation may constitute nonpublic material information that a corporation should disclose only in a very limited way.

A broad scope should not permit outside counsel and forensic accountants to endlessly fish.

If a corporation establishes a special investigating committee, it should issue a memorandum advising those concerned of the purpose and expected length of the investigation, the expectation of cooperation with the internal investigation and with the lawyers, and the need to preserve records, documents, or communications relevant to the investigation. A special committee should explain what cooperation is specifically expected from employees and the consequences for failing or refusing to cooperate, such as termination. Cooperation, for example, should include (1) providing, upon request, all documents and records related to a corporation's business whether kept in a person's office, home, or on a personal computer; (2) strictly complying with document hold and retention notices; and (3) submitting to interviews with the interviewing lawyers.

A special committee should also determine which employees will have their legal fees advanced or indemnified under either state law or existing bylaws, the company's ability to recommend counsel for individuals who the allegations that led to the investigation may implicate, and which employees are merely witnesses to the allegations for whom the company can provide "pool counsel," and the committee should also absolutely require that employees tell the truth to the investigating lawyers. Again, often a special committee, in-house counsel, or senior officers will send an investigation notice to the employees to signify the importance of the investigation and the need for complete and truthful cooperation. A written notice will also allay the fears or apprehension of employees who may have concerns about the alleged wrongdoing and possibly losing employment.

Inadvertently Establishing Joint Representation

Lawyers conducting internal investigations must be especially vigilant to avoid creating the impression with an employee that the lawyers jointly represent both the corporation or the special committee and the employee who the lawyers will interview. This often can become problematic when a lawyer interviewing an employee has represented the employee in the past in connection with other litigation as the corporation's regular outside counsel. This is yet another reason to hire independent counsel to conduct an investigation. *See United States v. Ruehle*, 583 F.3d 600 (9th. Cir. 2009) (reversing the trial court's finding that lawyers conducting an internal investigation created an attorney-client relationship with the CFO during an interview).

One of the problems that a corporation can have if an attorney inadvertently establishes an attorney-client relationship with an interviewed employee is that the employee must specifically authorize the release of statements that the employee made to counsel during an investigation interview. So a lawyer who releases an employee's interview statement could find him- or herself being sued for malpractice for having disclosed a confidential, attorney-client communication without the client's express authorization, which harmed the employee as a client.

A lawyer or lawyers interviewing an employee should advise the employee of the corporation's attorney-client privilege as it pertains to an interview with the employee as explained in the seminal case *Upjohn v. United States*, 449 U.S. 383 (1981). *Upjohn* warnings intend to advise an employee that counsel represents the corporation and does not represent the employee individually; the employee is being interviewed to assist counsel in gathering the facts so that the counsel can provide legal advice to the company; interviewing attorneys can and will share statements made by the employee during the interview with the company; the attorney-client privilege protects communications between counsel and the employee, but although the privilege protects the communications, the company owns this privilege, not the employee; the company alone can decide to waive the privilege at its sole discretion without notice to or consent from the employee; and the employee should understand that the company may decide to waive the privilege and disclose the contents of the interview to third parties, including state or federal law enforcement or regulatory authorities. Additional warnings should regularly explain that an employee should keep all aspects of the interview confidential, and the employee should not discuss the interview with others, including coworkers, with the exception of the employee's own attorney. That is, investigating attorneys should tell an employee, "aside from your own attorney, you may discuss the fact that you were interviewed, but you may not discuss the *substance* of what was discussed." Investigating counsel should apprise an employee interviewed during an internal investigation of his or her rights and responsibilities if prosecutors or regulators contact the employee and ask him or her to submit to an interview, including the right to invoke constitutional rights. Finally, investigating counsel should communicate that the company expects an employee's cooperation, and then discuss the potential consequences of the employee's failure to participate in the interview such as termination. *See* Upjohn Warnings: Recommended Best Practices When Corporate Counsel Interacts With Corporate Employees, ABA White Collar Crime Committee Working Group, July 17, 2009.

Most importantly, when a corporation and its directors, officers, or other employees have a preexisting relationship with investigating lawyers due to previous litigation, the lawyers need specifically to address the preexisting relationship and distinguish it as different from the matter currently un-

der investigation. In those instances, investigating lawyers should advise an employee that he or is she is being interviewed in connection with an internal investigation and the interview is not being conducted under his or her attorney-client relationship in connection with other representation. In addition, unlike any statements made to an employee in connection with the other matter, the corporation's attorney-client privilege will protect the statements that the employee makes during the interview underway or soon to take place, but the employee personally will not have a privilege over the statements. To avoid malpractice claims, early in an interview, investigating lawyers may want to obtain a written acknowledgement of the reading of the *Upjohn* warnings and a waiver of potential conflicts of interest from both an employee and the corporation because of the arguable dual representation.

Finally, New York City Formal Opinion 2004-02: Representing Corporations and Their Constituents in the Context of Governmental Investigations (June 2004), suggests that lawyers conducting internal investigations might take additional measures, such as including prospective waivers that would permit an attorney to continue representing a corporation in the event that the attorney must withdraw from the multiple representation, establishing contractual limitations on the scope of the representation, providing explicit agreements regarding the scope of the attorney-client privilege and permitted use of privileged information, and using "shadow" counsel to assist with representing the client for continuity if a specific attorney should need to withdraw.

Facing Federal Prosecution for Obstructing an Investigation

Employees should know when a federal government department or agency is conducting a parallel investigation. With the Sarbanes-Oxley Act of 2002, Congress enacted 18 U.S.C. §1519, which federal prosecutors have used to prosecute employees who knowingly alter, destroy, mutilate, conceal, cover up, falsify, or make a false entry in any record, document or tangible object "with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case." The government does not have to prove that an official government investigation was pending when the obstruction occurred or that the defendant knew that a federal department or agency had jurisdiction but only that the defendant's actions were related to or in anticipation of an investigation. *United States v. Gray*, 642 F.3d 371 (2d Cir. 2011). The federal government has prosecuted employees for obstruction for falsifying documents and providing false or misleading statements made to counsel in the course of internal investigations. *United States v. Yielding*, 657 F.3d 688 (8th Cir. 2011) (convicting the defendant for obstruction under §1519 after he was notified of a corporate internal investigation and then falsified a document, a promissory note, to cover up kickbacks and thwart the investigation).

Establishing an Attorney-Client Relationship by Answering "Do I Need a Lawyer?"

Answering "yes" or "no" when an employee asks "do I need a lawyer?" can constitute legal advice. Accordingly, lawyers conducting an internal investigation should respond to that question by advising a witness that the attorneys do not represent the witness, and if the witness wants to speak with counsel, the lawyers conducting the internal investigation will adjourn an interview for a reasonable time to allow the witness to consult an attorney who will represent the witness. If state law or a corporation's bylaws allow, a corporation may also consider indemnifying the employee's counsel-related costs and advancing fees and expenses. Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations, American College of Trial Lawyers, Feb. 2009.

Dealing with Exigent Circumstances

Sometimes exigent circumstances require investigating attorneys to interview employees immediately, with or without their personal counsel present. For example, under the Antitrust Division Corporate Leniency Program, the first corporation to qualify for leniency receives immunity from criminal prosecution. So a corporation has tremendous incentive to interview employees immediately to qualify for leniency. Under the policy,

> all directors, officers, and employees of the corporation who admit their involvement in the illegal antitrust activity as part of the corporate confession will receive leniency, in the form of not being charged criminally for the illegal activity, if they admit their wrongdoing with candor and completeness and continue to assist the Division throughout the investigation.

Interviewing counsel should prepare witness interview memoranda, if they intend to use them, soon after they finish each interview.

Memorializing Interviews

Counsel should memorialize investigation interviews so that they both preserve the attorney work product protection and serve the ultimate purpose of the investigation. Interviewing counsel should prepare witness interview memoranda, if they intend to use them, soon after they finish each interview. Fairness and the possibility that special counsel, regulators, or prosecutors, will use a witness interview memorandum during a follow-up interview suggests that the witness should receive it to review before that interview. Unless investigating lawyers have concerns about witness tampering, obstruction of justice, or other efforts to disrupt the integrity of an investigation, or difficulty retrieving and reviewing voluminous records, generally they should not interview employees before they have a chance to review the relevant documents. Recommended Practices for Companies and Their Counsel in Conducting Internal Investigations, American College of Trial Lawyers, Feb. 2008. Special counsel also should give a witness's counsel a rea-

sonable opportunity to review the memorandum about an interview for substance and to recommend possible modifications to avoid misstating or mischaracterizing a witness's statements and to address adverse inferences in corporate proffers. *Id*. Special counsel do not have to adopt modifications recommended by a witness's counsel, especially if they change what the witness communicated during an interview. *Id.* A special counsel should consider reading, explaining the substance, or showing a draft of an memorandum about an interview to the interviewed witness's counsel so that he or she can review it for accuracy, but the special counsel should not allow the employee to keep a copy of the summary to prevent someone from arguing that the corporation or the special committee has waived its attorney-client privilege and the attorney's work product privilege. *Id*.

Reporting the Results and Handling Follow-On Litigation

As noted above, because of the incentives encouraging self-reporting and disclosure, a corporation or a special committee and the lawyers conducting an internal investigation should anticipate that all the facts uncovered and all the witness interview summaries and documents associated with interviews may become known to or read by prosecutors, the government, regulators, or class action lawyers. For this reason, many lawyers adhere to the view that they should communicate the findings of an investigation to a client only orally. However, many regulatory schemes such as the FAR mandatory disclosure rule scheme require that a disclosure occur in writing. In other circumstances, it is important to have a written report to document the internal investigation fully for stakeholders and to list the recommended actions. For example, it was important for Penn State to disclose the "Report of the Special Investigative Counsel Regarding the Actions of The Pennsylvania State University Related to the Child Sexual Abuse Committed by Gerald A. Sandusky," of July 12, 2012, by former FBI Director Louis Freeh. The Special Investigations Task Force formed by the board of trustees engaged Mr. Freeh and his law firm as special investigative counsel to perform an independent, full, and complete investigation.

The structure of an internal investigation report should contain the following elements: a legend identifying the report as subject to the attorney-client privilege and work product doctrine; an executive summary of the findings and recommendations; a time line of the significant events; a section explaining the origin of the investigation; a summary of the relevant facts and any relevant yet unknown factual issues; an application of the law to the facts including an analysis of the company's or subject employee's potential liability and disclosure obligations; a section identifying recommendations for corrective action or preventive measures taken or that the client should consider taking; and an appropriate disclosure that the report contains the attorney's mental impressions and opinions concerning the credibility of persons who were interviewed and the attorney's assessment of the reasonable inferences drawn from those observations.

When an internal investigation concludes, the investigating lawyers should meet with the client to inform the client of the results, including what corrective action must take place and possibly how to implement it. These investigating lawyers must consider whether the client must or should make disclosures to the government or to regulatory agencies. And, last but not least, the lawyers who conducted an internal investigation ordinarily should not defend the corporation in follow-on litigation. To do so would call into question the independence of the lawyers conducting the investigation and the legitimacy of their work.

Conclusion

Lawyers conducting internal investigations have to avoid undermining their independence, credibility, or the results of their investigations vigilantly. They must likewise not prejudge the facts or issues or act as advocates. Rather, they must determine whether misconduct or a violation of a law or a regulation has occurred. And, the lawyers must create a final product that thoroughly explains what the investigation learned, provides an accurate and comprehensive legal analysis of the consequences, and recommend corrective action and disclosure if appropriate. By taking these steps, lawyers providing advice in connection with internal investigations can avoid, or at least adequately defend legal malpractice claims if they have to.