Rethinking Independence IN Internal Investigations

By Katia Bloom, Jessica K. Nall, and Joshua W. Malone

For a company facing allegations of internal misconduct, whether from government regulators or prosecutors, whistleblowers, or the plaintiffs' bar, an independent internal investigation performed by outside counsel may be an obvious next step. Often in these scenarios, outside counsel's "independence" is conflated with "absolutely no prior work done for the subject company." Indeed, some companies and boards categorically refuse to hire outside counsel to handle internal investigations if the firm has previously performed work for the company, out of concern that the government will assume such counsel cannot conduct an "independent" investigation.

CHEAT SHEET.

- *Defining independence.* The US Department of Justice recently published a checklist evaluating corporate compliance programs and notes only that an investigation should be "properly scoped" and independent, objective, appropriately conducted, and properly documented. Notably, the guidance does not state that a firm's prior work for a company disqualifies it as investigative counsel in all circumstances.
- *Ensuring objectivity.* The risks of perceived lack of objectivity can be cured by establishing reporting lines and forms of supervision that allow outside counsel to bypass a prior or existing client contact. Outside counsel should insist on complete authority to investigate where the facts take them, even if beyond the specific issues that gave rise to the investigation in the first place.
- *When to disqualify.* There are certain clear instances where a company's prior relationship with outside counsel should disqualify it from conducting an internal investigation, including if said counsel was involved directly or indirectly with the events in question.
- *Conflicts of interest.* Firms should be wary of potential conflicts of interest that may damage the perception of independence in the investigation.

Although an entirely new firm *should* be hired for an internal investigation in certain circumstances, imposing this sort of bright-line rule in every case may risk disqualifying a firm that is otherwise best equipped to handle a particular investigation. In many situations, investigative counsel can be diligent, objective, and independent despite having done some prior work for the client. Investigative counsel who are familiar with the inner workings of a company from a prior relationship can bring enhanced efficiency and understanding to the investigation that can be extremely beneficial to truth-finding as well as cost control. The point at which a prior counsel relationship may defeat independence must be considered on a spectrum.

Defining "independent"

As a threshold matter, while the government has stated that it favors "independent" investigations, it has offered little guidance on what that means. For example, the US Department of Justice's (DOJ) recent checklist evaluating corporate compliance programs notes only that an investigation should be "properly scoped" and "independent, objective, appropriately conducted, and properly documented."[1] Notably, the guidance does not state that a firm's prior work for a company disqualifies it as investigative counsel in all circumstances, nor does it state that some degree of prior work makes such counsel any less able to conduct an independent investigation. The US Attorneys' Manual focuses instead on the credibility of the investigation, noting that "[e]xactly how and by whom the facts are gathered is for the corporation to decide . . . . Whichever process the corporation selects, the government's key measure of cooperation must remain the same as it does for an individual: has the party timely disclosed the relevant facts about the putative misconduct?"[2]

In the context of US Securities and Exchange Commission (SEC) investigations, Exchange Act Rule 10A-3(b)(4) requires that audit committees be authorized to engage "independent" counsel but does not elaborate.[3] The SEC's 2001 Seaboard Report, listing criteria for evaluating corporate cooperation, only briefly mentions prior company work: "If outside persons [conducted the review], had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel?"[4] However, the report does not specify how the commission is to evaluate such facts and does not characterize prior company work as affecting credibility. Similarly, its enforcement manual discusses guidelines for company cooperation. It does not mention prior company work but instead highlights "four broad measures of a company's cooperation," including "self-policing prior to the discovery of the misconduct," "self-reporting of the misconduct when it is discovered," "remediation," and "cooperation with law enforcement agencies."

Because most internal investigations, especially for public companies, will need to satisfy auditors in addition to the government, it is also helpful to consider the applicable audit standard regarding the level of independence required for a credible investigation result. AU-C Section 500 (Audit Evidence) sets forth the audit standards that govern a public company audit that may rely on the findings of a "specialist" such as investigative counsel.[5] Notably, the audit standards provide that such specialists may be considered objective despite prior or current business relationships as long as other indicia of objectivity are present.[6] At least as far as the audit standards are concerned, the standard for credibility is "objectivity" rather than "independence," a concept that also seems to better describe the government's evaluation of credibility as a practical matter.

Reasonable versus bright-line standard

Although there are certain situations when a company's prior working relationship with outside counsel, especially if extensive, may impugn the credibility of an investigation, some amount of prior work by investigative counsel should not act as a *de facto* disqualifier.

First, taken to its logical extreme, this overly restrictive standard would potentially prevent companies from engaging counsel best suited to address a particular issue. Large companies regularly spread matters across a dozen or more law firms. If a company could not then choose one of these familiar firms for an internal investigation — when criminal liability and/or millions of dollars in fines are at stake — companies may be foreclosed from choosing the best qualified or most cost-effective counsel for a particular investigation.

Second, the risks of perceived lack of objectivity based on a prior working relationship can, in some situations, be cured through structural safeguards. Depending on the type of investigation at issue, a company can establish reporting lines and forms of supervision that allow outside counsel to bypass a prior or existing client contact. For example, investigating counsel who report directly to the board or audit committee (or another special committee where appropriate) are less likely to be perceived as being improperly influenced by pre-existing in-house counsel relationships.

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Similarly, if the audit committee makes the decision on which outside counsel to hire, this can signal to the government that such counsel were not selected because of a pre-existing relationship with in-house counsel. In an appropriate case, the lawyers within a firm who worked on prior matters can also be walled off from the investigation team. Regardless of the reporting walls put into place, investigating counsel should insist on complete authority to investigate where the facts take it, even if beyond the specific issues that gave rise to the investigation. Further, as the investigation proceeds, counsel should continuously monitor the relationship for any potential conflicts and alert the client if necessary.

Some legal commentators have suggested that hiring outside counsel for internal investigations who have done prior work for the company creates a risk of broad privilege waiver. One commentator recently noted that "if there is a later decision to waive the attorney-client privilege [following and about an internal investigation], a 'subject matter' waiver could jeopardize other communications with the same law firm that are on the same subject matter but did not occur in the investigation."[7] However, the risk of a broad privilege waiver is often overstated. Federal Rule of Evidence 502(a) provides that subject matter waivers attach when, following an intentional waiver of privilege to a federal agency, "communications or information concern[ing] the same subject matter . . . ought in fairness be considered together." Counsel should take this issue seriously when voluntarily disclosing material to the government by limiting direct quotes or references to prior work product on the same subject. But this issue is not unique to situations where a company's investigating counsel has previously worked with a company. Indeed, it assumes that separating earlier legal advice from later investigatory advice is more difficult just because the same firm is involved in both stages. The underlying subject matter of certain materials is not any more or less related just because the communications came from the same firm. Instead, counsel with prior company experience may be in a better position to know how its prior work might be implicated.[8]

When prior work is or is not valuable: real world examples

As their auditors will, companies individually should weigh whether outside counsel can conduct a thorough, objective, and ultimately credible investigation — and realize that there are instances in which a prior working relationship will be acceptable or even beneficial. For example, outside counsel with experience will often bring an in-depth understanding of the company's business operations and relevant personnel, which can be crucial in time- or dollar-constrained investigations. Likewise, if outside counsel previously worked as a company's employment counsel, it will be well acquainted with company policies regarding termination and thus able to quickly analyze employment repercussions — common issues in any internal investigation. Further, counsel's prior relationship with particular investigators — i.e., whether the firm has conducted prior investigations that have satisfied the government's inquiries — can make the government more likely to view its results as credible. Despite investigative counsel's prior work, the government is still very likely to grant such findings considerable weight where objectivity is otherwise present.

For General Motors' internal investigation of defective ignition switches, GM hired two law firms (King & Spalding and Jenner & Block) that had done legal work for the company. GM reached a favorable settlement with the DOJ more quickly and for far less than other car companies involved in similar defective ignition switch investigations.[9] Preet Bharara, the former US Attorney for the Southern District of New York, specifically cited GM's internal investigation and cooperation as a reason for the favorable settlement. "From the moment the top management came forward to disclose the defect in February of 2014," Bahara said, "the company's cooperation and remediation have been fairly extraordinary."[10]

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On the other hand, there are clear instances where a company's prior relationship with outside counsel *should* disqualify that counsel from conducting a subsequent internal investigation. For example, the government may view outside counsel as too self-interested to conduct an objective investigation if counsel was involved directly or even indirectly in the events under investigation. The seminal example is Vinson & Elkins' investigation into the Enron fraud allegations. Vinson was hired as investigative counsel despite the firm's role in helping to create several

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off-the-books investment partnerships that were a focus of the government's investigations.[12] The internal investigation concluded that the partnerships were legally appropriate, a result that did little to deter government scrutiny. Commentators have suggested that the perceived lack of objectivity of outside counsel led the government to place less weight on its findings and made the subsequent criminal investigation, SEC inquiry, and class actions more likely.[13]

A similar situation exists when the company's in-house or general counsel's advice is itself under investigation or where the actions of a non-lawyer client contact are under scrutiny. Because of the risk that investigating counsel may be perceived as reticent to make findings that might result in discipline of their prior or current client contacts, a fully independent firm should be hired. The perceived lack of credibility may also require completely "new" counsel to investigate some whistleblower complaints. Depending on the severity of the conduct alleged, a whistleblower's own perception of bias or fear of his or her identity being uncovered by long-standing counsel may make completely new counsel a safer choice.[14]

Further, in shareholder derivative suits, how the company's board (or special litigation committee) should weigh outside counsel's prior representation depends on the jurisdiction. In a shareholder derivative suit, because a plaintiff sues on behalf of the company, the plaintiff must demand that the company's board act to address the alleged wrong or demonstrate that the demand would be futile because a majority of the board is not sufficiently disinterested to decide whether to sue. In these "demand futility" suits, the company's board often creates a disinterested special litigation committee which, after an investigation that is often assisted by outside counsel, it is determined that prosecution of the claims would not be in the best interest of the company. But the company can win its motion to dismiss the derivative suit only if it can show that the assisting law firm was sufficiently independent.[15] Courts take different approaches on whether a company's prior relationship with a company constitutes a lack of independence. In one leading case, the US Court of Appeals for the Eleventh Circuit said that an outside counsel would lack independence only if it previously represented the same persons concerning "the very subject matter of the [shareholder] demand." Some courts in this limited context have adopted a strict per se rule against an outside counsel's prior representation of a company.[16] Other courts favor a more in-depth analysis that examines the nature of the prior relationship, noting that a relatively "modest" amount of legal work performed by investigating counsel will not weigh adversely on its independence.[17]

Finally, firms should be wary of other potential conflicts of interest that may damage the perception of an investigation's independence. For example, a law firm should decline working as investigating counsel where there is a personal relationship between counsel and subject(s) of the investigation that is material enough to cast doubt on its findings. In 2013, Gibson Dunn & Crutcher investigated then-New Jersey Governor Chris Christie's office for its role in the George Washington Bridge lane-closing scandal. Gibson Dunn's report did "not [find] any evidence of anyone in the Governor's Office knowing about the lane realignment beforehand or otherwise being involved, besides [Deputy Chief of Staff] Bridget Kelly."[18] The investigation has faced public scrutiny due to a lead partner in the investigation being friends with Christie and having vacationed with his family.[19] This relationship may well have cast a pall over the firm's investigation, which was criticized by a federal judge for its "opacity and gamesmanship" in a later motion to quash dispute with former administration officials seeking information from the probe. Indeed, there is an inherent conflict question in every internal investigation — by "independent" counsel or otherwise, because investigating counsel is almost always being paid to investigate by the very subject of the investigation. The safeguards outlined above may at least partially shield investigating counsel from scrutiny on the issue of inherent conflict, but these sorts of questions will invariably continue to arise.

Conclusion

In summary, outside counsel's independence should not be viewed as a strict binary determined solely by whether counsel had a previous working relationship with the company. The degree of independence required in a given situation should instead be considered on a spectrum, informed by the specifics of each case, with an overall eye toward counsel's objectivity under the particular circumstances. **ACC**

NOTES

1 US Department of Justice, Evaluation of Corporate Compliance Programs, available at *www.justice.gov/criminal-fraud/page/file/937501/download.*

2 US Department of Justice, U.S. Attorney's Manual 9-28:720; *see also id.* ("The extent of the cooperation credit earned will depend on all the various factors that have traditionally applied in making this assessment [e.g., the timeliness of the cooperation, the diligence, thoroughness and speed of the internal investigation, and the proactive nature of the cooperation])."

3 Exchange Act Rule 10A-3(b)(4) ("Each audit committee must have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties").

4 U.S. Securities and Exchange Commission, Seaboard Report (Oct. 23, 2001), available at *www.sec.gov/litigation/investreport/34-44969.htm.*

5 AU-C §500.A38.A39 et. seq.

6 *See* AU-C §§ 500.A.42-44 (discussing that a specialist may be more objective when provided with certain "safeguards . . . created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist environment (for example, quality control policies and procedures). The standards also suggest the company evaluate certain threats to objectivity, such as other potential "financial interests" and "business and personal relationships").

7 Dan Dunne, Compliance & Ethics Professional, Foxes and Henhouses (Aug. 2011) ("Ring-fencing earlier corporate advice from later investigatory advice is more difficult when the same firm is involved in both phases, and lines become blurred").

8 Further, a recent decision from the Southern District of New York strictly limited findings of subject matter waiver where reports are voluntarily provided to the government following an internal investigation. *See In re General Motors LLC Ignition Switch Litigation*, 80 F.Supp.3d 521 (S.D.N.Y. 2015). In General Motors, plaintiffs sought copies of interview memoranda prepared by G.M.'s lawyers during an internal investigation, arguing that G.M. waived attorney-client privilege by providing the government a report that cited to the memoranda. *Id.* at 523. Applying Rule 502, the court rejected plaintiffs' argument because the "company neither offensively used the Valukas Report in litigation nor made a selective or misleading presentation that is unfair to adversaries in this litigation, or any other," and fairness did not require disclosure, given the millions of pages of documents related to the investigation that G.M. was prepared to turn over. Id. at 534. Finally, Advisory Committee Notes to Rule 502 state that "a voluntary disclosure . . . to a federal office or agency . . . generally results in a waiver only of the communication or information disclosed."

9 Apuzzo and Vlasic, Toyota Is Fined $1.2 Billion for Concealing Safety Defects (March 19, 2014), available at *www.nytimes.com/2014/03/20/business/toyota-reaches-1-2-billion-settlement-in-criminal-inquiry.html.*

10 Ivory and Vlasic, $900 Million Penalty for G.M.'s Deadly Defect Leaves Many Cold (Sept.17, 2015), available at *www.nytimes.com/2015/09/18/business/gm-to-pay-us-900-million-over-ignition-switch-flaw.html* ("Mr. Bharara cited an internal investigation conducted for G.M. as favorable in determining the penalties paid by the automaker. The two law firms hired for that inquiry, King & Spalding and Jenner & Block, had previously done legal work for G.M. And court papers show that Anton R. Valukas, the chairman of Jenner & Block, who headed the G.M. investigation, helped represent the automaker in its talks with the Justice Department").

11 Sidley had previously represented a group of technology companies, including Yahoo!, in an amicus brief that it wrote in *In re Seagate Litigation* in 2007. See 2007 WL 1032685 (C.A. Fed.). Shearman had previously represented Wells Fargo Securities LLC, a subsidiary of Wells Fargo & Co., in a debt offering in 2015. See *www.shearman.com/en/newsinsights/news/2015/06/wells-fargo-in-fts-international-notes-offering.*

12 James Grimaldo and Peter Behr, Houston Law Firm Helped Craft Enron Deals (Jan. 27, 2002), available at *www.washingtonpost.com/archive/politics/2002/01/27/houston-law-firm-helped-craft-enron-deals/a4011343-6a7e-432b-a526-697849e9bf1d/?utm_term=.e8eea215d9c9.*

13 See, e.g., Enron's Lawyers: Eyes Wide Shut? (Jan. 28, 2002), available at *www.forbes.com/2002/01/28/0128veenron.html#2d2c81c8fa88.*

14 Dan Dunne, Compliance & Ethics Professional, Foxes and Henhouses (Aug. 2011).

15 *See Stepak v. Addision,* 20 F.3d 398, 405 (11th Cir. 1994) (applying Delaware law).

16 *See, e.g., In re Oracle Securities Litigation,* 829 F.Supp. 1176, 1189 (N.D. Cal. 1993) (requiring board "to retain counsel with no prior ties to the individual defendants or the corporation").

17 *In re Oracle Corp. Deriviative Litig.*, 824 A.2d 917, 925 (Del. Ch. 2003) (noting that counsel "had not performed material amounts of legal work for Oracle or any of the individual defendants before its engagement"); *see also General Electric Co. v. Rowe,* 1992 WL 277997 (E.D. Pa.) ("GE is one of the largest companies in the world and has 19 directors who sit on various other boards and are often officers of other major entities. Given these realities, there are probably few firms capable of supervising a special litigation committee in a matter like this that have not had some contact with GE or its directors. As a result, the relatively minimal contact between GE and Gibson, Dunn and Crutcher cannot support the assertion that the committee was a sham").

18 Report of Gibson, Dunn & Crutcher LLP Concerning Its Investigation on Behalf of the Office of the Governor ofNew Jersey Into Allegations Regarding the George Washington Bridge Lane Realignment and Superstorm Sandy Aid to the City of Hoboken, available at *http://online.wsj.com/public/resources/documents/nybridge0327.PDF.*

19 Bill Wichert, NJ Pol Blasts Trump's SEC Chair Pick Over GWB Scandal (Dec. 16, 2016), available at *www.law360.com/articles/873815/nj-pol-blasts-trump-s-sec-chair-pick-over-gwb-scandal; see also* Michael Barbaro, Inquiry Is Said to Clear Christie, but That's His Lawyers' Verdict (March 23, 2014), available at *www.nytimes.com/2014/03/24/nyregion/inquiry-is-said-to-clear-christie-but-thats-his-lawyers-verdict.html* ("[The report] will be viewed with intense skepticism, not only because it was commissioned by the governor but also because the firm conducting it, Gibson Dunn & Crutcher, has close ties to the Christie administration").

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