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ISSUES IN INTERNAL INVESTIGATIONS

In recent years, regulators have implemented a variety of initiatives to further incentivize timely self-reporting and cooperation. Increased regulatory emphasis on the speed with which companies detect and address misconduct highlights the importance of thorough and efficient internal investigations. This article discusses key considerations for companies and counsel before, during, and after an internal investigation.

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Securities regulators' emphasis on cooperation and prompt self-reporting has underscored the significance of timely and effective internal investigations.[1] Of course, not all such investigations have a regulatory or enforcement overlay. Internal investigations examine conduct with varying degrees of severity, culpability, and consequences, with potential violations of law an extreme example of inquiries that are more often concerned with potential deviations from company policy or other, prudential concerns. Nevertheless, the Biden administration's efforts to incentivize voluntary reporting and cooperation offer an opportune moment to reflect on key considerations when beginning, conducting, and concluding an internal investigation.

[1] *See, e.g.,* Speech, DOJ, Deputy Attorney General Lisa Monaco Delivers Keynote Remarks at the American Bar Association's 39th National Institute on White Collar Crime (Mar. 7, 2024), https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-monaco-delivers-keynote-remarks-american-bar-associations; Speech, SEC, Remarks at New York City Bar Association Compliance Institute (Oct. 24, 2023) https://www.sec.gov/news/speech/grewal-remarks-nyc-bar-association-compliance-institute-102423.

PREPARING FOR AN INTERNAL INVESTIGATION

The foundation for successful internal investigations can and should be laid well before matters requiring such inquiries arise. By giving advance consideration to factors that may inform an investigation's scale, pace, and execution, legal and compliance teams can ensure that their approach is efficient, consistent, and well-calibrated to address specific investigations' substance.

Although the precise nature of potential misconduct inevitably shapes the resulting investigation's scope and procedures, it is important to approach all internal investigations with rigor and emphasis on the integrity of investigative process, as one never knows what facts may surface. Policies and approaches will vary by company — a public international conglomerate will likely have different needs than a small broker-dealer — but many of the underlying issues remain the same. Key considerations at the outset of any internal investigation include: the nature of the potential misconduct; who inside and outside the organization may be implicated by that misconduct; how the organization learned about the misconduct; whether the misconduct has already received media or other public attention; and whether a law or laws were potentially broken. An anonymous

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complaint about alleged discriminatory hiring will likely warrant a different response from a law enforcement subpoena seeking evidence of accounting fraud — though both may cross the same in-house counsel's desk in the first instance.

Ensuring that legal and compliance teams have evaluated these considerations and developed their thinking on how to navigate various scenarios allows for a consistent, thoughtful, and defensible response to all investigations and helps avoid or mitigate time-consuming delays. Once a situation arises warranting further inquiry, a company's legal and compliance teams should promptly apply the investigative rubric they have developed to determine the appropriate next steps. They should also be prepared to revisit their approach as the investigation unfolds. Evaluation of the relevant considerations is necessarily iterative and may evolve over time if, for instance, the anonymous hiring complaint reveals systemic violations of state or federal civil rights laws.

Another important consideration at the outset of any investigation is whether the matter should be principally handled by an in-house team or outside counsel. Factors impacting this determination include whether the in-house legal and/or compliance teams have sufficient resources and expertise to conduct the investigation, whether anyone from or supervising the team is potentially implicated in the misconduct, and whether it will likely be important to demonstrate the investigation's independence. Both the appearance and reality of independence can matter when dealing with regulators, shareholders, auditors, or a company's board of directors. Regulators may also not afford as much weight to a seemingly self-serving finding by in-house counsel that there was no misconduct as they would to a similar determination by outside counsel, which had been empowered to conduct a robust review of the relevant facts. Under some circumstances, it may be possible to pursue a hybrid approach, where some initial collection is conducted by an in-house team, subject to protocols developed by outside counsel, in a manner calibrated to be time-and-resource efficient while still preserving the investigation's integrity and independence.

Whether using an internal team, outside counsel, or a combination of the two, it is important to develop and sustain a workflow that will appropriately protect attorney-client privilege. When considering these issues, counsel should be mindful of an enduring circuit split regarding whether "dual-purpose" communications (*i.e.*, communications that have a legal and non-legal purpose) are protected by the attorney-client privilege. The majority of jurisdictions use the "primary purpose" test to determine if dual-purpose communications are privileged.[2] In those jurisdictions, communications are privileged when the primary or predominant purpose of the communication was to receive or provide legal advice. On the other hand, the minority approach asks "Was obtaining or providing legal advice *a* primary purpose of the communication, meaning one of the significant purposes of the communication?"[3] Given this uncertainty, and the balance of authorities favoring a narrower application of the attorney-client privilege, developing a tight workflow to protect the privilege is essential. From the outset of any investigation, the legal team should be mindful of privilege when communicating about their work, diligent in making clear when a communication's purpose is to solicit, provide, or reflect legal advice, and clearly mark communications and documents as attorney-client communications and/or attorney work product when appropriate.

EXECUTING AN INTERNAL INVESTIGATION

Conducting an internal investigation presents complicated and often inter-connected issues, including the preservation of relevant documents, engagement with auditors, ensuring protection of whistleblowers, navigation of regulatory inquiries and potential self-

[2] *See, e.g., In re County of Erie*, 473 F.3d 413, 420 (2d Cir. 2007); *Better Gov't Bureau, Inc. v. McGraw (In re Allen)*, 106 F.3d 582, 602 n.10 (4th Cir.1997); *United States v. Robinson*, 121 F.3d 971, 974 (5th Cir. 1997); *Alomari v. Ohio Dep't of Pub. Safety*, 626 F. App'x 558, 572–73 (6th Cir. 2015); *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 601 (8th Cir. 1977).

[3] *In re Kellog Brown & Root, Inc.*,756 F.3d 754, 760 (D.C. Cir. 2014) (Kavanaugh, J.).

reporting, and assessment of potential conflicts of interest.

First, investigators must act quickly to retain potentially relevant documents without generating undue concern, alerting targets, or otherwise compromising the investigation. Counsel should expeditiously identify the individuals most likely to have materials relevant to the investigation, and a document preservation notice should be sent promptly, identify relevant topics and categories of materials, and be as clear and straightforward as possible. Although it is important to be comprehensive when outlining preservation obligations, counsel should also be mindful of retention notices' intended audience and ensure that action items can be parsed and understood by employees without legal training. It is important to revisit the identified custodians and scope of document preservation over the course of an investigation. In most cases, it is also appropriate to consult the organization's information technology department to safeguard against the intentional or unintentional deletion of materials. In recent years, regulators have developed a pointed and persistent concern surrounding the retention of text message data.[4] The Delaware Chancery Court has also been critical of counsel's failure to promptly preserve text data in connection with civil litigation.[5] As a result, investigators should carefully consider whether and when to collect and preserve such data.

Second, internal investigations must proceed mindful of an organization's external auditor, who will be interested in any allegations bearing on the integrity of the organization's financial reporting. If the allegations could implicate a company's financial statements' credibility or that of the corporate officers from whom the auditor takes representations, then the investigators should determine the appropriate time to advise the company's auditor. Informing the auditor of allegations early in the process and ensuring transparency on the investigation's progress can help ensure the auditor's satisfaction with the investigation's reasonableness and reduce the likelihood of delays in the completion of a company's audited financial statements. Counsel should of course remain mindful that sharing information with auditors generally waives the attorney-client communication privilege as to that information.

Third, if an internal investigation results from a whistleblower, then organizations must take seriously their responsibility to prevent retaliation. All organizations should have a clear anti-retaliation policy and regular training as to that policy's scope and application. The internal investigation should limit the identification of whistleblowers to a strict "need-to-know" basis within the in-house legal team and take great care to prevent the unintended identification of whistleblowers. Additionally, organizations should diligently review their employment, confidentiality, and separation agreements to ensure that they comply with SEC Rule 21F-17 of the Securities Exchange Act of 1934, which prevents companies from taking "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation."[6]

Several recent SEC actions underscore the government's commitment to enforcing existing whistleblower protections and imposing financial penalties for Rule 21F-17violations.[7] In January 2024, the SEC underlined this emerging trend by imposing its largest penalty to date for a violation of Rule 21F-17 —

[4] *See, e.g.,* Press Release, SEC, SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures (Sept. 27, 2022), https://www.sec.gov/news/press-release/2022-174; Press Release, SEC, Sixteen Firms to Pay More than $81 Million Combined to Settle Charges for Widespread Recordkeeping Failures (Feb. 9, 2024) https://www.sec.gov/news/press-release/2024-18.

[5] *Goldstein v. Denner*, 310 A.3d 548, 557 (Del. Ch. 2024) ("The hedge fund and its principal had a duty to preserve ESI. That duty arose at least as early as . . . when the hedge fund principal received the first litigation hold notice. The hedge fund and its principal failed to take reasonable steps to preserve texts, most notably by not imaging any personal devices.").

[6] § 240.21F-17(a).

[7] *See, e.g., In the Matter of Gaia, Inc*. et. al., Admin. Proc. No. 3-21438 (May 23, 2023) (imposing a $2 million fine on an internet streaming company for misconduct including retaliation against a whistleblower); *In the Matter of CBRE Inc*., Admin. Proc. No. 3-21675 (Sept. 19, 2023) (imposing a $375,000 civil monetary sanction against a national commercial real estate firm for language in its separation agreements that required departing employees to affirm that they had not filed complaints with any federal agency); *In the Matter of D.E. Shaw & Co., L.P*., Admin. Proc. No. 3-21775 (Sep. 29, 2023) (imposing a $10 million sanction against a registered investment advisor, which forbade employees from disclosing "Confidential Information" to anyone outside the company, with no carve-out for whistleblowers to communicate with the SEC about possible securities laws violations and required departing employees to sign a release in order to receive their deferred compensation stating that the employee had not filed any complaints with any governmental agency).

an $18 million fine against a large, multinational bank.[8] In this instance, the underlying conduct was boilerplate confidentiality provisions that authorized retail investors to respond to regulatory inquiries, but did not expressly permit them to proactively make disclosures to regulators. By nearly doubling the previous highest fine for similar conduct (which had itself only been imposed in Fall 2023), the SEC signaled to the market that whistleblower protections must be taken seriously.

When assessing whistleblower-related risks, in-house counsel and compliance teams should be aware that the Department of Justice (the "DOJ") has recently joined other securities regulators in deploying incentives designed to encourage whistleblowers. Just last April, the DOJ's Criminal Division unveiled a whistleblower pilot program "designed to provide predictability and certainty by offering a pathway for culpable individuals to receive [a non-prosecution agreement] for truthful and complete self-disclosure to the department."[9] This followed on the heels of similar programs announced by U.S. Attorneys Damian Williams in Southern District of New York, and Ismail Ramsey in the Northern District of California, for individuals who come forward with actionable, previously unknown information about non-violent crimes.[10] These new initiatives, along with existing SEC, CFTC, and FINCEN whistleblower programs, enhance the likelihood that individuals will externally report potential misconduct they observe in their workplace.

Fourth, when potential criminal or civil legal violations are involved, and in light of the aforementioned increase in whistleblower incentives, an increasingly important consideration during the course of the investigation is whether and when a self-report is in the company's best interest. Recent federal government policy initiatives reflect the Biden administration's focus on incentivizing prompt corporate self-reporting. Last year, the DOJ announced voluntary self-disclosure policies for its Criminal Division and U.S. Attorney's Offices nationwide. Under the new policies, "a company is considered to have made a VSD ("Voluntary Self-Disclosure") if it becomes aware of misconduct by employees or agents *before that misconduct is publicly reported or otherwise known to the DOJ*, and discloses all relevant facts known to the company about the misconduct . . . in a timely fashion prior to an imminent threat of disclosure or government investigation."[11] A company that makes such a voluntary self-disclosure and satisfies the policy's other requirements (*i.e.*, cooperation, remediation, and absence of aggravating factors) will receive significant lenience. Although data on self-reporting is not publicly available, DOJ leaders have noted an uptick in corporate self-disclosure.[12]

Notably, the DOJ reported increased self-disclosure before it announced its new whistleblower incentives. By alerting regulators to misconduct, whistleblowers close their employers' windows for voluntary self-reporting *before* the government is otherwise aware of the alleged issue. This in turn increases the importance of prompt and thorough internal investigations, which can quickly achieve an understanding of key facts and inform the decision of whether to self-report.

There is still limited precedent clarifying the mitigating impact of timely self-reporting under the current enforcement regime. However, regulators have been quick to tout what they characterize as significant tangible results from such reporting. The SEC has cited its enforcement action against GTT Communications as illustrative of early self-reporting's benefits.[13] GTT failed to disclose material information about unsupported adjustments in various SEC filings across three quarters, but undertook affirmative remedial

[8] *In the Matter of JP Morgan Securities LLC*, Admin. Proc. No. 3-21829 (Jan. 16, 2024).

[9] Blog Post, DOJ, Criminal Division's Voluntary Self-Disclosure Pilot Program for Individuals (Apr. 22, 2024) https://www.justice.gov/opa/blog/criminal-divisions-voluntary-self-disclosures-pilot-program-individuals.

[10] Press Release, DOJ, SDNY Whistleblower Pilot Program (Feb. 13, 2024), https://www.justice.gov/usao-sdny/sdny-whistleblower-pilot-program; Press Release, DOJ, U.S. Attorney Ismail Ramsey Announces Policies Underlying Whistleblower Pilot Program (Mar. 18, 2024), https://www.justice.gov/usao-ndca/pr/us-attorney-ismail-ramsey-announces-policies-underlying-whistleblower-pilot-program.

[11] DOJ, Criminal Division Corporate Enforcement and Voluntary Self-Disclosure Policy, JUSTICE MANUAL § 9-47.120 (2023); Press Release, DOJ, Damian Williams and Breon Peace Announce New Voluntary Self-Disclosure Policy for United States Attorney's Offices, https://www.justice.gov/usao-edny/pr/damian-williams-and-breon-peace-announce-new-voluntary-self-disclosure-policy-united.

[12] Mengqi Sun, DOJ Says More Companies Are Voluntarily Disclosing Possible Wrongdoing, THE WALL STREET JOURNAL (May 24, 2023), https://www.wsj.com/articles/doj-says-more-companies-are-voluntarily-disclosing-possible-wrongdoing-5398a842;.

[13] Rel. No. 98491 (2023); Press Release, SEC, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), https://www.sec.gov/news/press-release/2023-234.

measures, including self-reporting the issue to the SEC, announcing an internal investigation, attempting to remedy accounting and financial reporting issues, and cooperating with the SEC's investigation. Given GTT's actions, the SEC did not seek civil monetary penalties from GTT. The SEC emphasized in particular that GTT's self-report had come "[a]t a time when [GTT] was still evaluating the nature and impact of the accounting issues it had identified," that is, after internal investigators had determined there was an issue but before they had completed their work to fully understand it. After a recent round of SEC off-channel communication enforcement, SEC Director of Enforcement Gurbir S. Grewal similarly emphasized that one of the 16 firms received significant lenience because it self-reported and cooperated, with that firm's $1.5 million penalty more than $6 million less than the next lowest imposed.[14]

For its part, the DOJ has highlighted its recent decision to decline to criminally prosecute Proterial Cable America for fraud as similarly illustrative of the benefits of self-reporting. When explaining the decision not to prosecute despite determining that Proterial had engaged in fraud, the DOJ underscored the company's "voluntary and timely self-disclosure of the misconduct," and specifically noted the fact that the company "disclosed the issue to the Fraud Section within weeks of an employee raising the issue during an internal audit."[15]

When opting to make an early self-report, counsel should make clear to regulators that they are sharing a preliminary understanding of the facts and have not yet drawn a conclusion about violations of law or policy. Such early reporting serves to increase credibility and maximize the likelihood of cooperation credit, while also preserving counsel's ability to defend against resulting enforcement action. However, early self-reporters should proceed with the expectation that regulators are unlikely to defer to internal investigative interests moving forward and will make their own decisions as to what further investigative process is appropriate.

Finally, when dealing with potential violations of law, it is essential to stay vigilant for conflicts of interest as facts are developed during the investigation. If the investigation identifies or suggests a conflict of interest between the organization and one or more employees, then the organization should generally provide any conflicted employee with their own legal counsel to protect their interests. This ensures fidelity to attorneys' ethical obligations, allows the organization to vigorously defend its own interests, and helps prevent breakdowns in communication with regulators.

CONCLUDING AN INTERNAL INVESTIGATION

As an internal investigation concludes, organizations should assess any appropriate remedial action against responsible employees and determine what work product should result from the investigation.

Among the range of potential employment sanctions, organizations should consider clawing back or withholding compensation from individuals whom an investigation determines engaged in serious misconduct. In order to ensure their ability to do so, companies should develop and implement clear standards for when deferred compensation will be withheld, vesting rights will be terminated, and monies paid as a result of misconduct will be recovered. Effectively executing on such policies requires cooperation between and among Human Resources/Employee Resources, compliance, and relevant in-house counsel. Such coordination should entail an expedient determination of both the bonus and deferred compensation vesting schedules. As a practical matter, it is far easier to delay or prevent money from flowing from the organization to an individual than it is to recover money that has already been paid. Withholding a bonus or deferred compensation also allows an organization to show the government substantive remediation results rather than best efforts.

Much as an investigation's circumstances dictate its scope, the investigation's purpose and findings will often dictate the work product that results. Some investigations can conclude with an oral report or briefing. Others will warrant a written report. When deciding how to memorialize an investigation's findings, counsel should be alert to factors, including any written report's implications for privilege and the possibility that such a report will be shared with regulators. To the extent an investigation has been conducted on behalf of a board of directors, counsel must also be sensitive to ensuring a record sufficient to support the board's fulfillment of its fiduciary duties of care and loyalty with respect to evaluating the misconduct at issue and exercising judgment as to any appropriate remedial action.

[14] Press Release, SEC, Sixteen Firms to Pay More than $81 Million Combined to Settle Charges for Widespread Recordkeeping Failures (Feb. 9, 2024) https://www.sec.gov/news/press-release/2024-18.

[15] Declination Letter, DOJ, *Proterial Cable America, Inc.* (Apr. 12, 2024).

CONCLUSION

It is impossible to know what an internal investigation will uncover. Therefore, all internal investigations should be planned for, executed, and concluded in a thoughtful, process-driven manner. The current regulatory and enforcement environment is moving rapidly to further incentivize voluntary self-reporting and cooperation for both corporations and individuals. In order to successfully navigate the risk and rewards of this still-shifting regulatory landscape, corporations must do the work to develop processes that enable them to perform efficient, rigorous, and accurate internal investigations. ■