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The Changing Dynamics of Internal FCPA Investigations
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The Changing Dynamics of Internal FCPA Investigations

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Considerable literature has accumulated on the topics of whether, when, and how to initiate a corporate internal investigation. Among the common concerns of counsel have been structuring investigations to protect attorney-client privilege, taking steps to preserve documents and assure cooperation within the company, deciding whether inside or outside counsel should take the investigative lead, memorializing interviews, and preparing a final report.

The past three or four years, however, have seen a number of developments that have caused fundamental changes in how effective internal investigations are, or should be, conducted. Requirements of Sarbanes-Oxley legislation have given internal investigations greater prominence, both with regulators and with senior company managers and board members. More importantly, new laws and enforcement policies have substantially increased the likelihood that the results of investigations will ultimately be disclosed to government enforcement officials.

As a consequence, corporate managers and board members are faced with a number of new realities when contemplating internal investigations. The following are some emerging trends and changing standards in conducting effective internal investigations. These changes, evident in recent investigations to determine whether violations of the U.S. Foreign Corrupt Practices Act (FCPA) have occurred, also apply to investigations relating to other types of misconduct or regulatory violations.

More Internal Investigations—First, the number of internal investigations is plainly on the rise. Aggressive enforcement, Sarbanes-Oxley certifications and disclosure obligations, more active Audit Committees, and revised Sentencing Guidelines are bringing more issues to the surface which, once identified, are generating increasing numbers of independent reviews.

Greater Pressure for Speed—Although there have always been reasons for conducting internal investigations expeditiously, warnings by enforcement officials that reporting immediately is essential to getting credit for voluntary disclosure mean that counsel often must preliminarily investigate and assess a potential violation within a matter of days or weeks, not months.

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Likely Audit Committee Involvement—The greater responsibilities that Sarbanes Oxley has placed on Audit Committees are evidencing themselves in Audit Committees' taking a far more active role in many investigations. Not only is a company's Audit Committee more likely to be apprised of possible violations and ongoing investigations, but the Audit Committee may decide to actively oversee or direct an investigation. An Audit Committee may insist that counsel conducting an investigation report directly to it, and may separately retain counsel for substantive expert advice, or even to conduct an inquiry.

A Premium on Document Preservation—Taking steps to preserve potentially relevant documents has long been a first step when launching an internal investigation. In recent cases, however, enforcement officials have been aggressive in asking how promptly document preservation directives were issued, whether the directives went to the appropriate universe of recipients, whether there was follow-up, and whether the directive addressed all media of communications. The thoroughness with which this routine step is taken is viewed by some officials as a litmus test of a company's good faith and commitment to a thorough investigation.

E-mail and Electronic Files—The world of document preservation has been transformed by the importance and pervasiveness of documents in electronic form. Not only are electronic files often a massive and fertile resource for investigators, but they also present a host of issues that differ from those related to preserving hard copy documentation. Preserving electronic documents, preventing their deliberate destruction by wrongdoers, seizing electronic files, retrieving deleted files, and dealing with voluminous back-up tapes can profoundly alter the task of investigators and the costs of an investigation.

Warnings to Witnesses—With the odds of voluntary disclosure having shifted, the admonition traditionally given witness at the beginning of an interview should arguably have changed as well. As always, there continues to exist some tension—and a divergence of views—on to what extent a witness warning should be *Miranda*-like, fully and explicitly apprising the interviewee of the role of the investigator and the likelihood that the company will waive privilege and disclose interview results, and to what extent the admonition should meet ethical standards but not be so alarming as to chill or thwart the interview. In either case, the likelihood of privilege waiver and disclosure is generally agreed to be higher than it was several years ago, raising the question of how independent investigators should advise witnesses and how they should respond to the various process questions that witnesses frequently ask.

Investigations as Preventive Measures—Internal investigations traditionally have been, almost by definition, responses to potential issues or problems about which a company has learned. In more and more cases, however, companies are conducting independent investigations or reviews as diagnostic or preventive measures. A series of highly publicized cases arising in the M&A context has underscored that pre-merger FCPA due diligence is becoming a standard feature of overall pre-merger due diligence. Beyond M&A due diligence, independent reviews—often styled as "legal audits"—enable companies to identify issues early and deal with them on their own terms. Although such audits probably do not enjoy work product protection, they can usually be structured to be covered by attorney-client privilege.

Determining Whether an Issue Is Isolated or Systemic—In the context of voluntary disclosures, companies can increasingly count on being asked if they know whether the violation being disclosed is an isolated instance or a systemic problem. If the answer is "isolated," the follow-on question will likely be "how do you know?" In anticipation of this query, and in an effort to deflect it from becoming a suggestion that the company undertake a worldwide review, some companies conduct an internal review in advance, perhaps based on some reasonable, representative sample. Such a self-initiated review can be less onerous and less costly than a government-supervised investigation.

Questions for Counsel

The sharply increased likelihood that a violation will have to be disclosed "voluntarily," either to shareholders through SEC filings or directly to enforcement officials, is causing companies to re-think traditional assumptions about conducting independent internal investigations. Working backwards from the assumption that the odds of disclosure have risen, in-house counsel and company Audit Committees are asking themselves and their outside counsel some of the following new questions:

Should We Compress the Investigation?

Because enforcement officials are so strongly emphasizing the need to report possible violations promptly in order to receive credit for having voluntarily disclosed and fully cooperated, one question is whether investigations must be initiated immediately, accelerated, and conducted intensively. This may mean moving simultaneously on parallel tracks, concentrating resources quickly at the front end of an investigation, and setting tight deadlines.

Should We Set an Early Date for Deciding whether to Disclose?

An obvious corollary of speeded-up investigations is that a company may not have the luxury of fully evaluating a potential issue before deciding whether to disclose. One approach to ensure timely disclosure is to set an

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arbitrary deadline for deciding whether or not to disclose. For example, counsel may be given an initial mandate of learning as much as possible within three weeks, at which point the company will consider whether or not to disclose, based on all of the facts learned and information available at that time. Although such a scenario may force a decision on less than complete information, it avoids repeatedly deferring the disclosure decision in the name of seeking additional, more definitive facts or analysis.

Should We Make a Placeholder Disclosure?

An alternative, or compromise, is a so-called "placeholder disclosure," by which the company advises enforcement officials that it has learned of a possible violation, that it is actively investigating the matter, and that it will report back when it has additional information. The advantage of placeholders is that they enable companies to make early, tentative disclosures—avoiding the risk that the agencies themselves will otherwise learn of the same issue and deny the company credit for disclosing thereafter—while keeping open the possibility that it may yet prove to be a non-issue. The obvious flip side is that a placeholder alerts the government to an issue before you have fully diagnosed it and creates the risk that the agencies will not defer to your investigation, but instead closely monitor it, or even immediately open one of their own. In addition, unwinding a placeholder disclosure will likely require a convincing explanation to the government.

Should We Prepare a Written Report of the Internal Investigation?

Written reports have the well-known advantages of memorializing the results of a review (particularly valuable if the issue re-surfaces after some intervening delay), consistently communicating the results to all who receive the report, confirming the Audit Committee's involvement, and demonstrating the company's seriousness of purpose. Written reports may also contemporaneously record corrective, remedial, and disciplinary measures that the company has taken on its own in response to the issue. With increased demands for waiver of privilege as an indicator of full cooperation, however, there is an increased chance that enforcement officials may ask to see any final report. While such a request may be resisted for good and reasonable cause, such a conversation may be awkward and may be seen as inconsistent with otherwise unqualified disclosure of non-privileged communications and full cooperation. As a result, the calculus of whether and how to prepare a final report is different from that of a few years ago.

Should We Prepare a Disclosure Report?

An alternative may be to prepare a report for which disclosure is contemplated from the outset. Although the bottom line conclusions of such a report may be no different from those of a privileged report intended for internal use only, there may be differences in the scope of the report, the description of interviews, discussion of unrelated or potential issues, recommendations made, and the like. Thus, a report that is either not privileged, or for which privilege is expected to be waived, is another option for companies, and is sometimes done together with a privileged report that the company may decline to produce.

In an M&A Context, Should Resolving Open Issues Be a Condition of Closing?

In some recent, well-publicized FCPA cases, acquiring companies that discovered possible FCPA violations during pre-merger due diligence insisted that the target company disclose and resolve any issues prior to closing. Although some enforcement officials have suggested that all open issues discovered during M&A due diligence should be handled in this fashion, the issue should be considered on a case-by-case basis. While resolution prior to closing may be necessary in some circumstances, in others, it may not be. A requirement to settle all issues prior to an approaching closing deadline can make an M&A transaction hostage to an enforcement issue that is minor by comparison, and this approach gives enforcement officials total leverage in setting the pre-conditions and terms of settlement.

The pressure created by this scenario has in some reported cases given rise to massive, enormously costly global investigations conducted under short deadlines. In at least one celebrated instance—Lockheed's proposed acquisition of Titan in 2003—the merger transaction foundered in ensuing months because the investigation and settlement of the charges could not be completed in time, and in other cases the costs of complying have been extraordinary. Although each situation must be evaluated individually, there are plainly circumstances in which making the resolution of open issues a pre-condition to closing may not be the wisest strategy.

How Can We Achieve Efficiencies and Cost-Effectiveness in Internal Investigations?

In part because the stupendous costs of some recent FCPA internal investigations have been publicly discussed, there is growing and understandable interest in how to conduct thorough investigations as efficiently and cost-effectively as possible. Platoons of lawyers or accountants may be unavoidable in certain circumstances, but most internal investigations, even complex ones, do not require them. Clients can demand cost-effectiveness without necessarily trying to control an investigation or compromise its independence, and law firms can develop techniques and design investigations in ways that will achieve significant efficiencies while assuring a rigorous and independent

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review. Doing both requires open communication and some careful balancing, as well as good faith cooperation by both client and lawyer. However, the costs of commodity-style internal investigations are generally unnecessary and are increasingly unacceptable to clients.

Finally, How Can We Reduce the Pain of Having a Compliance Monitor?

The emerging trend of including in all FCPA settlements (and certain non-FCPA settlements) the requirement that the company retain an independent compliance monitor has introduced a significant new element into FCPA enforcement. An unbroken string of such cases, together with suggestions by enforcement officials that independent compliance monitors may become routine, requires companies making voluntary disclosures or otherwise facing enforcement actions to anticipate the implications and costs of being forced to retain an independent compliance monitor.

If monitors do indeed become *de rigeur*, an important question facing companies with violations will be whether and how they can minimize the cost and burden of a monitor and his or her mandated review. It remains an open question whether the manner of the company's independent investigation, the extent of its cooperation, the promptness and decisiveness of its remedial measures, or other factors can affect the length of the monitor's tenure or the scope of the monitor's mandate. As the cost of a compliance monitor has in some cases rivaled or exceeded the amount of the financial penalties imposed, these yet unanswered question may also become important strategic considerations in the changing dynamics of internal investigations.

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