www.bankdirector.com

DirectorCorps **Strong Board.** Strong Bank.

Bank Director's Educational Program for Members of the Board

THE CORPORATE FIRST RESPONDER:
15 Questions to Consider When a Corporate Crisis Strikes

WHITE PAPER

SULLIVAN & CROMWELL LLP

Michael M. Wiseman
is the managing partner of Sullivan & Cromwell's Financial Institutions Group.

Sharon L. Nelles
is a partner in Sullivan & Cromwell's Litigation Group.

Marc Trevino
is the managing partner of Sullivan & Cromwell's Executive Compensation and Benefits Group.

Executive Summary

When a business enterprise is confronted with a situation that suggests that there has been a violation of law, the judgments made at the outset may well be critical to the ultimate outcome. Indeed, poor choices concerning how the matter should be handled— perhaps made in a rush and almost certainly without full facts—may prove even more prejudicial and damaging to the enterprise than the underlying conduct. As has often been said, corporations get into real trouble more often due to "flunking the investigation" than due to the conduct being investigated.

The objective of this article is to identify issues that should be considered when a potential violation of law surfaces, and to venture some thoughts on the considerations relevant to addressing them. The article presents 15 questions to consider at the outset of any crisis investigation. All of our questions will not be relevant to all situations, and there will undoubtedly be others that will need to be answered in whatever situation you may face. That said, we chose these 15 questions because, based on our experience, they provide the decision-maker with sufficient insight to develop a picture of the challenge facing the enterprise—and, of equal importance, of what the decision-maker does not know.

We intentionally have not prioritized the questions because they are so interrelated. It is not possible to answer many of them until some consideration has been given to all of them.

We offer one caution in approaching a newly discovered problem. Sometimes you may find that there is no real issue but merely a misunderstanding. But once a real problem is identified, as one probes it, it seldom gets better. As Admiral Nimitz exhorted the fleet in the context of storms of a different sort, "[n]othing is more dangerous than for a seaman to be grudging in taking precautions lest they turn out to have been unnecessary."[1]

Our 15 questions and related commentary follow. In addition, so that the questions can be close at hand when needed, they are set forth without the commentary in Annex A.

© DirectorCorps 2013

Question 1: Has the conduct stopped?

It is an obvious principle that illegal conduct must be stopped as soon as it is uncovered. When faced with illegal or improper conduct, the enterprise must demonstrate its total intolerance of, and swift response to, such conduct to its employees, its shareholders, its regulators and the public. If misconduct is allowed to continue once known by the enterprise's governance and control structure (such as the legal department), the enterprise's exposure is exponentially increased. At a minimum, if later investigation reveals that an illegal scheme was uncovered and ignored or disregarded, or that the company proceeded at too leisurely a pace, the firm's ability to argue for leniency will be compromised.

Often, misconduct involves junior or isolated individuals. In such circumstances, the damage to the enterprise sometimes can be cabined. However, if misconduct is allowed to continue once known by senior officers or control functions, the enterprise's exposure is exponentially increased. Stopping illegal conduct—or conduct inconsistent with the enterprise's norms of behavior—once it is discovered must be the first priority.

Question 2: Are adequate steps being taken to preserve relevant documents and other materials?

Once potentially illegal conduct is identified, a critical immediate step is to freeze promptly all possibly relevant documents, including, for example, electronic data, hard copies of documents and phone records.[2] Document retention and collection are necessary both for the purposes of the enterprise's internal investigation and in order to satisfy any external demands. Failure to retain relevant documents may result in extreme consequences, including, for example, allegations of obstruction of justice and adverse presumptions.[3]

Although burdensome and expensive, document collection and retention are necessary to protect the interests of the enterprise, as well as those of employees, and the enterprise should fight the urge to limit those efforts. Indeed, the enterprise should carefully consider whether to engage a third party to develop the retention and collection plan. Taking the preservation processes out of the hands of the enterprise and its employees is an effective prophylactic, particularly as the question "who knew what when?" sometimes unfolds in unexpected ways.[4]

An enterprise should never risk leaving potentially key documents in the hands of personnel who may unwittingly delete or destroy them—and perhaps later be called upon to account for their actions. In many circumstances, the documents will be in the possession of employees potentially involved in the issues being investigated, and any actions they may take with respect to their documents will be evaluated in hindsight from that perspective. In reality, a collection plan is a shield for firm personnel. Ultimately, there is no better answer when asked "what happened to your documents?"—than: "I gave open access to counsel/investigators, who came and took anything and everything they wanted."[5]

Many enterprises undertake document preservation and collection simply by sending a notice to employees to hold or send materials. This approach, if not supplemented, creates substantial risks. Understanding and communicating effectively with relevant employees regarding the necessity for document preservation and collection also is crucial. Sometimes collection can be done without the knowledge of custodians, but often that is not the case,[6] and the collection process can become alarming for employees (and disconcerting to the responsible internal team, which often wants to hold close the fact of an investigation). It may help alleviate anxiety to explain that by having the enterprise take charge of collection the enterprise is relieving its personnel from responsibility.

Though document and information collection efforts need to be sufficiently broad to allow the enterprise to get a full understanding of what occurred, the enterprise should also be cognizant of avoiding overreaching during collection efforts. Issues discovered in a discrete area of the enterprise or a discrete business unit are not an invitation to investigate

© DirectorCorps 2013

the entire enterprise. Overbroad collection efforts are expensive and will disturb business units and employees not involved in the crisis. Firms should carefully tailor document retention efforts so as not to overburden the business and yet be able to collect the discrete set of relevant documents that will fully illuminate the facts.

Question 3: What substantive legal issues does the conduct raise?

Improper conduct may implicate multiple state and federal laws as well as regulatory schemes. As an example, consider a bank employee who doctors the bank's books over time to divert substantial sums to his personal use. Assume further that in the course of concealing the diversion, the employee makes misrepresentations not only to management, but also to the bank's independent auditors and to bank examiners. This scenario raises a host of possible violations focusing on the culpability of the individual, including theft, falsification of bank books and records, misleading the bank's auditors and misleading the examiners.

Although the bank, its accountants and examiners are victims of the individual's conduct, the bank itself also may face liability. For example, as a matter of federal and state law, an employer is generally responsible for the acts of an employee acting within the scope of his employment.[7] Even though the employee's conduct may contravene the employer's policies and interests, that conduct may still be considered to be the actions of the employer if they occurred in the course of the individual's employment. Thus, the bank in our example could potentially be held liable for the misrepresentations made to auditors and regulators. Depending on the circumstances, the bank may also have liability under laws that are based on books and records violations, including the Foreign Corrupt Practices Act. Taking the time to identify the scope of the substantive legal issues is crucial to, among others, choosing your response teams and developing your evidence preservation plan.

Question 4: Who are the relevant regulatory and enforcement authorities?

As the enterprise considers which legal issues are raised and what the governmental response may be, it is also necessary to identify which authorities have jurisdiction. Identifying the enforcement authorities and regulators that may have an interest in the matter is an important step that will inform many of the firm's procedural and substantive decisions. Such jurisdiction may arise because of the nature of the conduct (e.g., the Securities and Exchange Commission (the "SEC") and Department of Justice if anti-fraud provisions of the Federal securities laws are violated) or because of the status of the entity (e.g., the state utility commission if the fraud occurs at an energy company or banking regulator if it occurs at a bank). Moreover, other Federal and state authorities may have jurisdiction (e.g., state criminal, banking and securities authorities). It is also common to see situations in which non-U.S. authorities have jurisdiction due to the location of the conduct or regulatory status of the institution. It is important to identify all the relevant authorities early. Authorities initially ignored take poorly to being invited late to the party and may feel that they need to take steps to ensure they are perceived as relevant in future situations.

At this juncture, the crisis team needs to begin considering whether and when to raise the issues identified with the relevant authorities. And if so, how and with whom should they be raised? This question illustrates the fundamental proposition that uncovering a crisis should not be the catalyst for an enterprise to begin a relationship with its regulators. Initiating and maintaining longstanding good relationships with one's regulators should be a priority of the firm. A conscientious effort on the part of the firm to build up a reputation for openness, responsiveness and integrity can create an environment of trust and goodwill with the firm's regulators, and the public, that may become important in a crisis situation. It is also critical to communicate to the regulator that the firm and the regulator are on the same side once a crisis has arisen. Once an investigation is

© DirectorCorps 2013

initiated, both parties want to uncover full facts, end illegal conduct, and work toward preventing similar conduct in the future.[8]

When to contact regulators regarding a crisis is another issue to consider. As one reference point on timing, if it is clear that the matter will inevitably become public, a firm will want to initiate contact with its regulators well before the regulators read about it in the press. But even if it's unclear whether the matter will be publicized or remain quiet, early communication with a regulator will in almost all circumstances prove beneficial. Governmental authorities are more inclined to demonstrate leniency toward firms that actively self-report and are cooperative than to those that delay. Further, early outreach may allow the enterprise to keep control of the investigation and thereby enable the enterprise to take sufficient time to get a handle on the facts and develop an appropriate response.

Of course, the firm must be careful not to get ahead of itself in terms of suggesting facts and conclusions to a governmental authority that are not yet fully supportable. For this reason, reports typically proceed in steps, with the first substantive reports being preliminary in nature. Importantly, any preliminary report should make clear that (i) it is preliminary; (ii) facts are still being found and (iii) the firm may not yet have a full understanding of the facts already before it. Usually, it is useful to describe in such preliminary reports both what has been done and what is expected to be done going forward. To avoid misunderstandings later, any limitations, such as missing data or the inaccessibility of important witnesses, should be noted early in the process.

Question 5: Did the conduct affect the books and records of the enterprise or suggest weakness in financial controls?

This question is important for several reasons. First, if the answer is yes, it may implicate separate legal violations apart from the underlying conduct. Second, an affirmative answer suggests the need to involve promptly the enterprise's independent auditors. In such cases, the auditors will have their own procedures to follow to meet their obligations. It is critical to ensure that the approach to the problem taken by the enterprise will meet the needs of its auditors, because it is unlikely that a response that is deemed insufficient by the firm's auditors will be satisfactory to the firm's board or its regulators. In many of these cases, involving the auditors earlier will avoid missteps. On the other hand, if the auditors are involved in assessing the matter, the enterprise will need to consider the implications of their involvement for maintaining attorney-client privilege and work product protections.

The third reason this question is important is that the answer will affect the need for disclosure in the case of a public company, thus also implicating regulatory reporting considerations. In extreme situations, an enterprise may need to assess the potential for restatement of previously published financial statements.

Question 6: How should the matter be escalated within the institution?

Although the enterprise may have procedures for escalation in place, and these are a useful starting point, there are a number of factors that nonetheless need to be considered in any given case. Those factors include: (i) ensuring that the issue is raised to a level senior to those possibly involved; (ii) determining whether the conduct needs to be escalated to the board of directors or specific board committees, such as the audit committee, due to the nature of the conduct or the seniority of those possibly involved; (iii) apprising and involving control functions such as internal legal, compliance and audit; and (iv) possibly engaging media and investor relations personnel. Clearly, although escalation must be prompt, it also must be done carefully to involve the right people and at the same time avoid, to the extent possible, unnecessary dissemination of sensitive information and possible leaks.

Unless senior management is implicated in the crisis and it appears improper for them to lead the investigation, the full board, or an appropriate committee thereof, should be kept informed of the situation as it

© DirectorCorps 2013

develops but generally should otherwise allow management to oversee the firm's response to the crisis. In some circumstances, however, the board or a committee must be tasked with leading the investigation. For example, in the case of issues involving the accounting books and records of the institution, it may be appropriate for the audit committee to oversee the investigation. Similarly, a board committee may take charge of the conduct if it appears senior management may be involved. In these cases, it is useful to consider in advance the procedures that will govern how the investigation will be managed by the board, including best use of outside lawyers, accountants and media advisors. Depending on the circumstances, counsel for the board or committee could range from the general counsel and regular outside counsel (reporting directly to the board or committee for this purpose) to truly independent counsel who have had no dealings with the institution in the past and who forsake future dealings for some reasonable period.

Question 7: How should the team working on the matter be organized?

Once improper conduct is asserted or discovered, it needs to be decided who should investigate the matter. The necessity of involving counsel in situations involving potentially illegal conduct is clear; the question is, what counsel and under whose direction? There are several considerations in play in such a decision, including the level of independence required of the investigators and the level of involvement of the enterprise's board of directors. As we have discussed, in most circumstances it will be appropriate for the management of the firm to direct the investigation, often led by its general counsel.

In any case, the enterprise will need to assemble a team with sufficient independence and expertise. It may be appropriate, for example, for internal legal personnel, especially in the early stages of the investigation and before the nature and extent of any misconduct is known, to handle the investigation but perhaps using a team that was not involved in representing the business unit in which the conduct in question occurred. Indeed, in the early stages of an investigation, it is often most useful for internal counsel who are well versed in the business practices of the firm to take the lead. In other cases, or once it is clear that some level of illegal conduct has likely occurred, it may make sense to involve outside counsel to establish the independence of the inquiry, as well as to obtain greater expertise in the relevant area and experience in allocating resources and communicating with governmental authorities. It may also be in the institution's interest to involve outside counsel to provide comfort to regulators or ultimately the public as to the seriousness and objectivity with which the institution is approaching the problem. Often regular outside counsel is well positioned to take on this work efficiently.

Sometimes true independent counsel with no relationship to the enterprise will be required to satisfy regulatory procedural requirements and public perception, for example, when the allegations involve very senior management and have received press attention. Likewise, where misconduct is raised through a shareholder demand on the board, depending on the allegations, it may be desirable for the board to establish an independent committee advised by independent counsel to assess the claim and the interest of the firm in pursuing it. In all circumstances, it is important to get this structure right in order to avoid the possibility of a "re-do" of the investigation, and possibly even an investigation of the investigation. When stakes are high, it may make sense to vet the proposed approach with the relevant constituencies, including potentially regulators, law enforcement, the independent auditors, and media and investor relations advisors.

Question 8: What will be the scope of the investigation and will the enterprise cooperate?

Although sometimes difficult, critical questions to be decided at the outset are the scope of the investigation and whether the institution will "cooperate" with regulatory authorities and law enforcement. Factors to consider when determining scope—in other words, how wide to draw the investigative circle—include, for example, the location of the suspected wrongdoing in the corporate structure,

© DirectorCorps 2013

the seniority of the persons with knowledge and the enterprise's sensitivity to the matter. Reaching initial agreement on scope will provide concrete direction for the investigative team and the oversight function. It also will help eliminate or clarify the "turf wars" that can arise in high-pressure situations.

Once the lawyer and client agree on the scope of the review or investigation to be conducted, we have found that it is useful to memorialize that understanding. Sometimes, the document will also contain the division of labor among counsel or between counsel and client functions, such as internal audit. As the matter evolves, the document memorializing the understanding can be revised, but such a document helps ensure that (i) matters within the intended scope are not overlooked, (ii) the investigation does not wander beyond its agreed scope without further consultation with the client and (iii) there is a common framework against which to benchmark progress. The document might also address whether the investigation will lead to an oral or written report. Furthermore, it can be useful to share such a document with any relevant governmental authorities and obtain their agreement explicitly on scope so that down the road there is no misunderstanding as to what was and was not being looked into.

Consideration of cooperation requires an understanding of what a commitment of cooperation means to governmental authorities. It involves far more than prompt compliance with government discovery requests, which the authorities view as a firm's basic legal obligation. Instead, it has come to involve a probing self-examination of the underlying conduct and disclosure to the government of facts that might well not be discovered in the adversarial process.[9] Given the nature of cooperation, a firm should fully understand the implications before making a commitment to cooperate, including protocols for conducting interviews and preparing investigation reports. It should be noted that in drafting the initial public disclosure about a problem, adding language that the firm is cooperating will be viewed by the authorities and knowledgeable analysts as not simply a statement of good citizenship but rather as a public statement by the firm of a commitment to cooperate. When a firm has made such a statement of cooperation and subsequently failed in the government's view to cooperate, the inclusion of that statement has become a separate subject of investigation.

Both in designing an internal review and thereafter in reporting on its findings, consider any limitations arising from the circumstance of the review that affect the degree of certainty attaching to the findings. For example, testimony or documents from third parties may be very relevant to the investigation. In some cases, the firm will have relationships with the third parties that will allow reasonable access. For example, in the case of a former employee, a severance agreement may mandate cooperation. Similarly, the third party may be an entity with an ongoing relationship with the firm (e.g., a professional firm) such that the third party will make people and materials available. In other cases, however, the firm may not have such access, or have only limited access.[10] Then, the need to consider the effect of the limitation on the certainty of the findings needs to be carefully weighed and fully disclosed to the recipients of the findings. This issue can be especially problematic when the recipients of the findings include governmental agencies that do have access to those third parties. The government may pursue such third parties, once called to their attention, using the greater discovery resources at its disposal.

Question 9: Who, if anyone, in the enterprise needs to be isolated from participation in the investigation or separated from the enterprise?
Obviously, potential malefactors need to be excluded from participation in the investigation, both so that there is no perception that they affected the result and so that they do not have access to information that would pollute their recollection as witnesses. The enterprise may also want to consider excluding immediate supervisors and direct reports of those whose conduct is in question. First, as the investigation proceeds, it is possible such personnel will be implicated in the wrongdoing, either truthfully or as a tactic by the malefactors to defend their position. Second, participation of such personnel may taint

© DirectorCorps 2013

the perception of the investigation, as they may be viewed as less than objective with respect to something that went wrong in their area. A strong case can, therefore, be made that a broader approach to exclusion is in the interest both of the institution and the excluded individuals—although they may not initially see it that way.

The exclusion of alleged or potential malefactors goes hand-in-hand with the question of immediate discipline and termination. Instinctively and in the face of public pressure, firms may feel they need to terminate immediately any employees implicated in the investigation. In some cases, such swift action can speak louder than words and gain favor with the enterprise's regulators even if it might alienate loyal employees. However, firms should approach pressure to terminate immediately with great care.[11] The level of discipline imposed should vary with the severity of the uncovered conduct, which likely is unknown at the outset. Moreover, it may be necessary to retain employees implicated in the problem in order to facilitate their cooperation with the investigation. While the employee is still employed by the firm, the firm may exercise some influence over the employee. Once he or she leaves, that influence is lost, the likelihood of cooperation is then decreased, and the chance that the employee may seek to harm the firm is increased.

In short, it is generally in the enterprise's best interests to investigate and interview fully all or a substantial portion of the employees implicated in a crisis before it begins disciplining any. Discipline, if it is to be used wisely, should generally come after full facts have been uncovered and the scope of the matter is well understood. Then, it is clearer what happened and thus easier to determine disciplinary measures that are more fair, appropriate and proportionate to the individual's involvement. Moreover, the dismissal or other punishment of more junior employees too early in the process may be mistaken for scapegoating—an approach that all of the firm's constituencies are likely to find unattractive and unsatisfactory.

Question 10: Does the enterprise have unique reporting obligations to enforcement and regulatory authorities?

As discussed above, there are often good reasons to communicate with governmental authorities early, in terms of both the outcome of the problem under investigation and the firm's overall regulatory relations. Sometimes, however, it is not a choice because the enterprise has a unique reporting obligation under industry rules and regulations. Whether such a reporting obligation exists needs to be determined immediately.

For example, in the context of financial institutions, there is often a requirement to file a suspicious-activity report (or SAR) with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury. Such reports are available to various regulatory and law enforcement authorities and must in general be filed if there is a reasonable suspicion that illegal conduct has occurred either against the institution or through the institution's facilities. A SAR must be filed within 30 days after discovering the conduct if the institution can identify a suspect, or otherwise within 60 days. If the conduct is ongoing, an immediate report is required. The trigger for filing is reasonable suspicion, not proof. Because a firm can itself be pursued for not filing a SAR when required, there is a strong bias in favor of filing. This bias is further supported by the facts that SAR filings are treated confidentially and that there is a safe harbor to protect SAR filers.[12] It is important to note (and it is not intuitive) that a SAR filing is required when the institution learns of the activity from a governmental agency (presumably for the benefit of the other agencies with access to the SAR database).

Question 11: What are an enterprise's public reporting and disclosure obligations?

Companies with securities registered with the SEC must carefully consider their disclosure obligations with respect to the discovery of potentially illegal conduct. A threshold question is whether the matter under review would be material to investors. The case law and literature on what is material are

© DirectorCorps 2013

voluminous, and beyond our scope. A basic working definition of material information is whether there is a substantial likelihood that a reasonable investor would consider the information as significant in making an investment decision, given the total mix of information available to the investor.[13] In weighing whether information about a possible event is material, one takes into account both its likelihood of happening and its significance if it does happen.[14] Moreover, materiality is not just a question of immediate financial impact. Other relevant considerations include the implications for the issuer's long-term business model and regulatory licenses, what it reveals about the management of the issuer and what it suggests about the issuer's control structure. In its Staff Accounting Bulletin 99, the SEC staff has indicated that it does not accept that materiality is merely a question of the dollars involved.[15] Indeed, it suggests that inaccurate financial data intentionally entered into the issuer's books for the purpose of causing a misstatement in its financial statements is always material.

Under the Federal securities laws, however, deciding that information is material does not mean that it must immediately be disclosed. Although that may be the approach taken by many non-U.S. securities market disclosure regimes, like the United Kingdom[16], the U.S. securities laws follow a different approach. Generally, while it may be required by listing rules to be disclosed promptly, there is some flexibility not to disclose material information under the Federal securities laws until there is a triggering event. Such events include:

(1) Disclosure is specifically required by an SEC report, such as Form 10-K, Form 10-Q or Form 8-K;
(2) The issuer or an affiliate intends to offer securities for sale;
(3) Under SEC Regulation D, if an issuer discloses information selectively and without a confidentiality undertaking, it must disclose the information publicly;
(4) The information must be disclosed to correct a prior statement that was incorrect when made;
(5) The issuer has expressly or impliedly undertaken a duty to update the market on the relevant topic;
(6) The information has leaked from the issuer;
(7) The issuer intends to make announcements to a broad internal audience, such that it anticipates leaks; or
(8) The issuer is disclosing other information and the failure to disclose the information in question might be viewed as rendering the proposed disclosure materially misleading.

Often the question presented is whether disclosure need be made immediately or can wait until the next periodic report is filed. Assuming that the information is not responsive to one of the limited number of mandatory filing requirements in Form 8-K, then, absent the kind of special circumstances enumerated above, the issuer may be able to wait, though this decision should be vetted with disclosure counsel.

Even aside from the need to fulfill its legal disclosure requirements, there may be other reasons to disclose sooner rather than later. Often an earlier disclosure can be made in sufficiently generic terms to allow it to remain in place until the matter is advanced enough to make more precise disclosures as the investigation proceeds. If the issuer waits to disclose until it absolutely must do so, the precipitating event, a leak for example, can force disclosure at a time, such as early settlement discussions, when it is especially difficult to craft good and balanced disclosure. In short, it may be better to be on the front foot with disclosure than caught on the back foot. In making public statements, it is critical to recognize that all constituencies will carefully scrutinize them. In the case of regulators and law enforcement, they can be expected to carefully review the statements of firms under investigation or that they regulate. Any perceived misstatement, omission or misleading statement can become the subject of investigation. Moreover, the authorities can be expected to test the public statement both against what they have been told privately and against developments subsequent to the statement (e.g., on issues such as the intent to cooperate).

© DirectorCorps 2013

Increasingly, large international institutions must satisfy the requirements of more than one securities disclosure regime, and managing the differences between the U.S. and applicable non-U.S. regimes presents a challenge to be monitored carefully as a matter evolves.

Question 12: What is the enterprise's press strategy?

If the conduct under investigation is destined to become public, the enterprise should consider involving a public relations or investor relations advisor. These professionals can help the firm coordinate its media coverage and can work toward ensuring that the firm is treated equitably by media outlets. The firm should take into account, however, that communications with such public relations advisors, unlike those with attorneys, may not be privileged. When the relationship with such advisors is to assist counsel in advising the institution through the crisis, that structure should be explicit in the retention materials to maximize the likelihood that the privilege will be protected. Privilege, however, will not turn on the formality of whether the public relations advisor is retained by, and reports to, counsel contractually, but also on the actual working relationship between the advisor and counsel.

Question 13: Are there personnel issues, and what process will be followed to deal with them?

The approach taken from the outset to dealing with the institution's personnel should be designed to achieve the objectives of (i) treating them fairly, both while the matter is being reviewed and when any discipline is administered, (ii) dealing with them in a way that is effective in eliciting the information the firm needs, (iii) demonstrating to any relevant regulatory and law enforcement agencies that the firm is pursuing the matter in a serious and effective manner and (iv) avoiding unnecessary disruption to the conduct of the firm's business.

From the outset, information will likely be developed through employee interviews. Although there is necessarily a desire to move quickly, careful thought should be given about (i) whom to interview, (ii) in what order people should be interviewed, (iii) what document review, if any, should precede the interviews and (iv) who will be present at, and keep notes of, the interviews. Although one wants to get at the facts quickly, interviews of groups should be avoided, as the authorities may misconstrue group interviews as opportunities for the group to get their story straight. Indeed, each employee should be asked not to discuss the matter with others inside or outside the firm.

When an employee is first interviewed, it is critical that the employee understand that the lawyer conducting the interview, even if it is someone with whom the employee regularly consults, is representing the firm and not the employee. Thus, any attorney-client privilege belongs to, and can be waived by, the firm, including by disclosing the fact or substance of the discussion with the employee to relevant regulators. Making that point clearly is a matter of fundamental fairness to the employee.

Communications of that point should be memorialized in the notes of the interview. The question whether the employee had an attorney-client relationship turns on the employee's reasonable expectations. Thus, establishing the ground rules clearly is necessary. Failure to establish clearly that the firm is the client could prevent the firm from disclosing the substance of the interview to third parties, conflict the lawyer from further participation in the matter and create considerable unhappiness on the part of any governmental authorities as to how the matter was handled.

It is common for an employee to ask whether the employee should have his own counsel. *That is legal advice the lawyer for the firm should not give.* In other circumstances, an employee may simply ask for counsel. Even absent that request, the firm may decide on its own that certain employees should be separately represented. In our experience, it is often desirable for the firm to offer to help the employee retain counsel and to pay reasonable counsel fees. That approach is certainly fair to the employee, but it is also often the best way to get at the facts.

© DirectorCorps 2013

Given the complexities of the facts involved in many investigations and the passage of time since they occurred, letting the employee sift through recollections and documents before going on the record can be very productive. Moreover, because the employee knows that what he says may be given to governmental authorities, if the government later decides that his statements were false, it may consider pursuing him criminally for making false statements to the government. Perhaps the government will also consider the role of the firm and its counsel in making those statements. It is in everyone's interest for the employee to get it right the first time.

We have already discussed above the desirability of collecting the employee's documents early and with as little participation by him as possible. This protects both the employee and the employer if there is a question about the document production later. We also have discussed the reasons to avoid rushing to judgment when it comes to the question of discipline for misconduct or conduct that simply does not meet the employer's expectations for its employees. We now turn to the question of discipline itself.

First, we believe that this question is not normally one to be left to the investigators. The lawyer involved may be best suited to lay out the facts for management, and may provide advice on the tactical consequences of certain employment actions, such as the resulting legal rights of the employee or the likely reaction of relevant government agencies. In the end, however, discipline is an issue for management. It may be handled through established human resources procedures or by an *ad hoc* process set up to deal with the situation. We have often seen clients address employee conduct in the context of a significant issue by setting up a panel drawn from different areas of the firm with relevant expertise to determine the appropriate course. In the end, in our experience, a reasoned, proportional response that tries to deal fairly with the relevant individuals at all levels of seniority is ultimately the best approach in terms of satisfying all the interested constituencies.

In closing, let us also touch on one other personnel issue that arises in, or more accurately, gives rise to, investigations—the whistleblower. This is a separate and complex topic with its own body of literature. We shall simply observe that the enterprise needs to undertake to understand the allegations with as much precision as possible and pursue them diligently. It is useful to try to partner with the whistleblower insofar as it helps draw out his concerns. To that end, you may wish to assure the employee that you will keep the employee posted on the matter but do not agree to share the results of your investigation, as you may be unable to do so. In all events, take, and make a record of taking, vigorous measures to ensure that there is no retaliation against the whistleblower.

Question 14: What are the potential damages and other collateral consequences that could flow from the issue, and when might you have a feel for actual likely outcomes?

In situations where there is misconduct within the enterprise, there is no question more important to the enterprise than possible consequences. The obvious first issues are monetary and cultural: penalties, the cost of the inevitable civil litigation that follows any major problem, impact on share price, and loss of personnel and impact on staff. There also may be any number of collateral legal consequences. Those consequences are highly dependent on the precise nature of the company's business, how it is regulated, the nature of the conduct at issue and what legal provisions are found to have been violated. Consequences can include debarment from government contracting, loss of necessary regulatory licenses, prohibition from certain activities (e.g., acting as a trustee) and forfeiture of the right to use certain exemptions (e.g., the ERISA QPAM exemption and various exemptions from registration under the securities laws). In extreme cases, such as a bank convicted of money laundering activities, it could actually result in the revocation of its charter. Some consequences follow automatically, unless a court or regulator affirmatively grants relief, while others are within the discretion of a governmental agency. The collateral consequences analysis for a complex firm, especially in a regulated industry, is often very

© DirectorCorps 2013

complicated. Further, management is sometimes hesitant to think about collateral consequences too early, lest it be viewed as conceding culpability. There are, however, at least three good reasons to undertake this analysis relatively early in the process. First, having at least a preliminary understanding of the potential collateral consequences is important to managing the process and determining the materiality of the problem. Knowing the potential collateral consequences of various potential resolutions also informs the decision of which ones may be more acceptable in terms of moving toward a resolution. Second, the disproportionate nature of some of the collateral consequences of various resolutions compared to the conduct involved may be one of a firm's best arguments for the government not pursuing the course that triggers those consequences. Finally, the consequences of a given outcome may be so complex and involve so many agencies that it will be almost impossible to deal with the situation when it arises if the firm is not well prepared.

Question 15: What ongoing activities of the enterprise, such as RFPs, need to be monitored to prevent contagion risks?

A firm is constantly disclosing information about itself and making representations about itself. We discussed above the public disclosure obligations, but the daily activities of a large firm also entail making numerous statements to regulators, customers (including governmental entities) and other constituencies. These may arise in formal contexts, such as regulatory applications or Requests for Proposals. They may also occur during less formal interactions. Although confidentiality around an investigation is important, so is putting steps in place to avoid inadvertently creating new problems by making statements inconsistent with what has been learned during a pending investigation.

© DirectorCorps 2013

There are a number of other issues we could have discussed that are relevant to investigating, evaluating and resolving a significant problem uncovered at an institution. The 15 we described may be somewhat arbitrary; but if addressed thoughtfully, these 15 should provide a good start to successfully handling the matter. One final thought. Every problem is different, and, while experience can suggest issues to consider, there is no simple recipe for success.

Questions Presented

1. Has the conduct stopped?

2. Are adequate steps being taken to preserve relevant documents and other materials?

3. What substantive legal issues does the conduct raise?

4. Who are the relevant regulatory and enforcement authorities?

5. Did the conduct affect the books and records of the enterprise or suggest weakness in financial controls?

6. How should the matter be escalated within the institution?

7. How should the team working on the matter be organized?

8. What will be the scope of the investigation and will the enterprise cooperate?

9. Who, if anyone, in the enterprise needs to be isolated from participation in the investigation or separated from the enterprise?

10. Does the enterprise have unique reporting obligations to enforcement and regulatory authorities?

11. What are an enterprise's public reporting and disclosure obligations?

12. What is the enterprise's press strategy?

13. Are there personnel issues, and what process will be followed to deal with them?

14. What are the potential damages and other collateral consequences that could flow from the issue, and when might you have a feel for actual likely outcomes?

15. What ongoing activities of the enterprise, such as RFPs, need to be monitored to prevent contagion risk?

© DirectorCorps 2013

[1]Letter from Fleet Admiral Chester W. Nimitz, Commander in Chief, U.S. Pacific Fleet, to PACIFIC FLEET and NAVAL SHORE ACTIVITIES, Pacific Ocean Areas, Confidential Letter 14CL-45, 18 (Feb. 13, 1945) (on file with the Operational Archives Branch, Naval Historical Center, Washington Navy Yard).

[2]In Federal Courts in New York, the enterprise has an affirmative duty to preserve evidence once "litigation [is] reasonably anticipated." *Zublake v. UBS Warburg LLC*, 220 F.R.D. 212, 216-17 (S.D.N.Y. 2003). New York State courts have begun to adopt that standard as well. See *VOOM HD Holdings LLC v. EchoStar Satellite LLC*, 939 N.Y.S.2d 321, 324 (App. Div. 2012).

[3]See, e.g., *United States v. Lundwall*, 1 F. Supp. 2d 249 (S.D.N.Y. 1998); see generally United States Sentencing Commission, *Guidelines Manual* § 3C1 (Nov. 2011); United States Department of Justice, *Principles of Federal Prosecution of Business Organizations ("DOJ Corporate Prosecution Principles"),* 9-28.730.

[4]It is important to obtain an understanding, not only of the document retention practices of relevant individuals, but also of the firm's document retention policies, backup systems and locations of data. Any automated purges of potentially relevant documents conducted by the firm should be identified and suspended. In large organizations, this can be a complex and time-consuming undertaking in itself and should be addressed from the outset.

[5]An employee will have an obligation to turn over any relevant data, but will also have an ongoing responsibility/obligation to retain relevant data that will not be alleviated by the initial document collection.

[6]In certain circumstances, especially in document collections that take place outside of the United States, it is required (or at the very least prudent) to obtain signed document collection waivers from employees, waiving any privacy rights to their company documents. International privacy law is currently a very dynamic area, and it may be prudent to discuss current relevant laws with local counsel, either internal or external.

[7]See, e.g., *United States v. Potter*, 463 F.3d 9, 25-26 (1st Cir. 2006); *Standard Oil Co. of Texas v. United States*, 307 F.2d 120, 126-127 (5th Cir. 1962).

[8]For a regulated enterprise, keeping in close communication with regulators can also help uncover and extinguish minor issues before they become a crisis. These firms should be in a continuous dialogue with regulators and should be aware of the issues that their relevant regulators are currently finding objectionable. Effectively, regulated firms should be monitoring regulators as actively as regulators are monitoring them. Noting which way the wind is blowing can help firms stay ahead of problems; firms must be aware of the regulatory issues their competitors and players in similar industries are facing and must consider whether those issues affect them.

[9]DOJ Corporate Prosecution Principles, supra note 2, § 9-28.700-28.760; Report of Investigation and Commission Statement on the Relationship of Cooperation to Enforcement Decisions, Exchange Act Release No. 44969, 76 SEC Docket 220 (Oct. 23, 2001).

[10]This can be an issue in international contexts where local laws prohibit disclosure of information or documentation to U.S. regulators.

© DirectorCorps 2013

[11]Placing the concerned employee on paid leave may be a useful option. It removes the employee from day-to-day operations of the company, but also leaves the employee available for interviews and follow-up matters.

[12]31 U.S.C. § 5318(g)(3).

[13]See *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

[14]See id. at 238-39.

[15]SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45151 (Aug. 19, 1999).

[16]United Kingdom Financial Services Authority, *Disclosure Rules*, Chapter 2, *Disclosure and Control of Inside Information by Issuers* (October 2012) (requires disclosure of material non-public information "as soon as possible" subject to delay in limited circumstances discussed in DTR 2.5.1).

© DirectorCorps 2013