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Benjamin Gruenstein, Charles Loeser, Bradley Niederschulte and Miriam Rosenbaum, A Primer on Corporate Investigations (February 2020)

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Corporate misconduct, if not properly addressed, can lead to a variety of negative consequences for companies, ranging from negative press and market reaction to private litigation or even criminal prosecution. Internal investigations may help to mitigate these untoward consequences by identifying the misconduct and providing a basis for a remedial plan of action. An investigation may include interviewing witnesses, retaining and reviewing documents, identifying culpable individuals and summarizing findings and recommendations in a report. Such investigations may be prompted by an external event, such as a subpoena from a government regulator, or internally by a whistleblower call to a hotline. The first question we consider is when a company *must* proactively conduct an internal investigation as a matter of law, and when a company *should* do so as best practice.

I. WHEN AND WHY SHOULD A COMPANY COMMENCE AN INTERNAL INVESTIGATION?

A corporation must conduct an internal investigation in situations where an employee is presently engaged in illegal conduct, and failure to do so would constitute criminal activity on the part of the corporation itself. "It is well established that traditional vicarious liability rules ordinarily make principals or employers vicariously liable for acts of their agents or employees in the scope of their authority or employment."[2] Corporate vicarious liability arises under the theory of *respondeat superior*, the common law doctrine of agency that creates liability for a third party who has the power to control the activities of a violator.[3] Corporations can be prosecuted criminally or civilly under this theory for the illegal acts of their employees. For a corporation to be held liable, the offending employee must have committed the wrongdoing (i) within the scope of his or her employment and (ii) with the intention, at least partially, to benefit the corporation.

Further, directors and officers may personally face criminal liability for illegal acts attributed to the corporation, including when they intentionally or negligently fail to adopt reasonable measures for crime prevention. Even if a corporate officer does not participate in an employee's misconduct, the officer may be liable for the misconduct when he should have foreseen that his own acts or omissions—such as a failure to conduct a reasonable internal investigation exposing the employee—would allow the misconduct to take place. Thus, an internal investigation following a

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2. *Meyer v. Holley*, 537 U.S. 280, 285 (2003).
3. *See* Restatement (Second) of Agency § 219 (1958).

suspicion of employee misconduct may protect the corporation itself, as well as its directors and officers, from vicarious criminal and civil liability.

Companies may also be required to conduct an internal investigation pursuant to the Sarbanes-Oxley Act of 2002 ("SOX"), a U.S. law that outlines requirements for public companies and companies in the process of becoming public. The law was enacted in reaction to a number of turn-of-the-century corporate scandals, such as those at Enron, Tyco International and WorldCom, and describes a company's responsibilities and potential penalties for failure to comply. When President George W. Bush signed SOX into law, he described its provisions as "the most far reaching reforms of American business practices since the time of Franklin Delano Roosevelt."[4]

Several of SOX's provisions require, or present strong incentives for, companies to conduct internal investigations. For example, Section 302 of SOX creates a powerful incentive for CEOs and CFOs to investigate known or suspected misconduct because a failure to do so places them at risk of individual liability. Section 302 requires CEOs and CFOs to certify in the company's periodic reports that "the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading."[5] It also requires a company's CEO and CFO to individually ensure that the company's internal controls are sufficient to recognize suspected misconduct, that they have evaluated those controls and that they have informed the company's auditors of any significant deficiencies in the internal controls. SOX imposes significant penalties on both companies and officers for noncompliance with its provisions.[6]

State law may also impose duties on corporations and their officers to conduct internal investigations in the face of potential illegal activity. For example, under Delaware law, a board has "a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards."[7] A corporation and its officers may be held liable for violating their so-called

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4. Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud In Corporations*, N.Y. Times (July 31, 2002), https://www.nytimes.com/2002/07/31/business/corporate-conduct-the-president-bush-signs-bill-aimed-at-fraud-in-corporations.html.
5. 15 U.S.C. § 7241.
6. *Id*.
7. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996).

Caremark duties if plaintiffs can show "(1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation and (4) that such failure proximately resulted in the losses complained of."[8] Thus, under Delaware law, both the corporation and individual directors may be liable if they fail to conduct an internal investigation when they knew or should have known about potential illegal activity.

Regulations that apply to specific industries also compel and encourage companies to conduct internal investigations. For example, the Environmental Protection Agency audit policy, "Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations," outlines incentives for regulated entities to voluntarily discover and fix violations of federal environmental laws and regulations, such as a reduction in potential penalties.[9] Likewise, the Occupational Safety and Health Act of 1970 requires an employer to "furnish to each of his employees employment and a place of employment which are free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees"[10] and creates a duty to investigate and report accidents.[11]

Of course, there are costs—of time and money—associated with conducting an internal investigation. Internal investigations may be particularly expensive if a company retains outside resources, such as outside counsel, forensic accountants and computer-forensic experts. Internal investigations may also disrupt and distract employees at the company. Further, a factual record of the investigation, if not developed correctly and with appropriate regard for attorney-client privilege, may provide an unintended blueprint for regulators or private litigants seeking to assert claims against the company or employees.

Yet, a company may glean tremendous benefit from conducting an internal investigation:

First, an internal investigation will not only assist a company in stopping misconduct, but in minimizing the risk of recurrence. This is done by identifying and potentially terminating culpable employees and

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8. *Id*. at 971.
9. Environmental Protection Agency Final Policy Statement (FRL 6576-3), effective May 11, 2000.
10. 29 U.S.C. § 654(a).
11. *See* United States Department of Labor, OSHA, *Incident [Accident] Investigations: A Guide for Employers*, https://www.osha.gov/dte/IncInvGuide4Empl_Dec2015.pdf; *see also* United States Department of Labor, OSHA, *Incident Investigation*, https://www.osha.gov/dcsp/products/topics/incidentinvestigation/.

by recognizing opportunities for improvements in policies and procedures to address the weakness highlighted by the investigation.

Second, the results of an internal investigation allow a company to accurately assess its liability exposure, which is particularly helpful in considering whether the liability is material and should be disclosed, whether to self-report the illegal activity to government agencies and how to prepare for and defend the company in potential litigation.

Third, in the event that the company does decide to self-report to the government, it must conduct an internal investigation in order to obtain credit for cooperation. "Thorough" cooperation is judged by whether the disclosed information is "sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible for the criminal conduct," and may reduce the ultimate severity of civil or criminal punishment.[12]

Fourth, conducting internal investigations where appropriate demonstrates to employees the seriousness with which the company takes its compliance obligations, and will strengthen a company's culture of ethics and compliance and in turn deter future instances of wrongdoing. In a recent survey, the Ethics Compliance Institute found that as compared to employees in weak ethics and compliance cultures, employees in strong cultures are 38% less likely to observe Foreign Corrupt Practices Act violations, 76% less likely to observe False Claims Act violations and 65% less likely to observe other white-collar crimes.[13]

Finally, a company's willingness to conduct an internal investigation in response to a report of possible illegal behavior may encourage potential whistleblowers to bring issues to the company's attention, before or in lieu of going to the government. By showing employees that it takes complaints seriously enough to conduct thorough proactive internal investigations, a company may discourage whistleblowers from immediately reporting concerns externally. Of course, a company cannot take steps to prevent a whistleblower from approaching the government, but it is good corporate governance to take steps to address concerns internally rather than wait for the government to bring those concerns to its attention.

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Ultimately, all allegations must be taken seriously and require a response commensurate with the nature, specificity and credibility of the

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12. U.S.S.C. Chapter 8, Commentary (2018), https://www.ussc.gov/guidelines/2018-guidelines-manual/2018-chapter-8.
13. Ethics & Compliance Initiative, *EthicsStats July 2018* (2018), https://www.ethics.org/knowledgecenter/ethicsstat/.

allegations. When mandated by law or regulation, companies must conduct an internal investigation. And when an investigation is not mandated, companies should consider the potentially significant benefits of undertaking one voluntarily, which often outweigh the costs and intrusiveness of doing so. Next, we consider a question that arises in cases when the government initiates its own investigation, namely whether the company should go beyond conducting its own internal investigation by taking the additional step of cooperating with the government's investigation.

II. WHEN AND WHY SHOULD A COMPANY COOPERATE WITH A GOVERNMENT INVESTIGATION?

Cooperation goes beyond merely complying with the government's demands for information. Companies must always cooperate to the extent required by law, or risk being held in contempt. For example, a company that receives a subpoena must comply with it by collecting and producing documents, but is under no obligation to volunteer information that has not been requested. Cooperation, for which credit can be obtained in the form of leniency, goes beyond what is required by law, and can be accomplished in a number of ways. The Securities and Exchange Commission (the "SEC") and Department of Justice (the "DOJ") have both issued guidance concerning what they consider to constitute full cooperation. This guidance suggests that to cooperate fully, a company must conduct a thorough review of the nature, extent, origins and consequences of the misconduct; identify all individuals substantially involved in or responsible for the misconduct at issue; provide the government with all information relevant to the underlying violations and the company's remedial efforts; and assist the government in making cases against others.[14]

Cooperating with the government may be onerous and expensive, and should—like all important corporate decisions—be undertaken after weighing the costs and benefits to the company. Cooperation can yield substantial benefits. Companies that actively cooperate may enjoy leniency from the relevant government agency, generally in the form of reduced penalties or charges. Studies have shown that "cooperating with SEC and DOJ enforcement actions often results in greatly reduced monetary

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14. *See* U.S. DEP'T OF JUSTICE, JUSTICE MANUAL §§ 9-28.700, 9-28.720, 9-28.740; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Co-operation to Agency Enforcement Decisions, Release No. 34-44969 (Oct. 23, 2001) ("Seaboard Report"), http://www.sec.gov/litigation/investreport/34-44969.htm.

penalties."[15] In addition, the government may enter into a favorable form of settlement when a company actively cooperates. For example, the government may offer a declination (*i.e.*, the government declines to prosecute the company for any alleged wrongdoing), a non-prosecution agreement (*i.e.*, a contractual agreement between the company and the government in which the government agrees not to bring criminal charges in exchange for certain actions by the company, like a payment of monetary fines or admission of wrongdoing) or a deferred prosecution agreement ("DPA") (*i.e.*, an agreement with the government where criminal charges are filed with the court but prosecution is postponed for a certain period of time in exchange for the company taking certain actions). All of these possibilities are, of course, preferable to a standard criminal prosecution without any reduction of charges or decrease in penalties.

Cooperation can be costly, however. Cooperation requires a company to take two additional steps that it would not otherwise undertake in the course of a standard internal investigation: (1) it must report to the government facts learned during its own investigation; and (2) it must help the government build a case against others. This goes beyond what the government may require, such as documents and testimony compelled through the issuance of subpoenas. But not so far beyond, as the government can derive the "facts" that the company learned during its own investigation, through its own review of key documents and interviews of key witnesses. As such, by using routine tools of criminal investigations and discovery, the government can typically learn the results of a company's internal investigation even when the company does not cooperate, albeit the process for doing so may take longer, and be more onerous for both the government and the company.

But the government cannot force a company to take the additional step of assisting it in building cases against others, whether employees or other companies. And the costs of doing so may be considerable. For example, a company may decide after a short internal investigation that an executive engaged in conduct worthy of termination. But to develop the sort of case that supports a criminal prosecution can be much more time- and cost-intensive. And the government may not stop at prosecuting the executive in question; the government may want to investigate and prosecute other companies or other executives at other companies.

15. *See, e.g.*, Alan Crawford, *Research Shows It Pays To Cooperate With Financial Investigations*, IMPACT (June 2014), http://pac.org/wp-content/uploads/Impact_06_2014.pdf.

A recent decision by Chief Judge McMahon of the U.S. District Court for the Southern District of New York illustrates just how costly cooperation can be. That case, *United States v. Connolly*, arose out of the LIBOR-rigging investigation of several banks, including Deutsche Bank, by the DOJ and other federal agencies. In the years leading up to the indictment, Deutsche Bank conducted a sweeping internal investigation, and ultimately entered into a DPA with the DOJ.

Chief Judge McMahon was highly critical of the degree of coordination that the government required of Deutsche Bank to ultimately secure the DPA. Deutsche Bank and its counsel cooperated with various government agencies for years in connection with the investigation, and their cooperation—and indeed, coordination—was extensive. Chief Judge McMahon found that, in the course of its investigation, the government directed Deutsche Bank to take specific investigative steps.[16] For example, Deutsche Bank interviewed employees at the government's request, and even in a manner dictated by the government.[17] And in one instance, Deutsche Bank sought the government's permission to interview its own employee.[18] All told, Deutsche Bank's counsel conducted nearly 200 interviews of more than 50 bank employees, reviewed 158 million electronic documents and listened to 85,000 audio files, conducted 230 phone calls and 30 in-person meetings with government officials, held weekly update calls for the final 14 months of the investigation and produced large volumes of documents and data, flagging "notable evidence or information it believed would be of particular interest to the Government."[19] Not only that, but this was "the largest and most expensive internal investigation in the respective histories of both Deutsche Bank and [the law firm]."[20]

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16. *United States v. Connolly*, No. 16 CR. 0370 (CM), 2019 WL 2120523, at *4 (S.D.N.Y. May 2, 2019) ("Deutsche Bank representatives and counsel continued to update the Government about their findings and coordinate next steps, as to Black and others. The Government gave [the Company's lawyers] marching orders during these meetings.").
17. *Id.* ("A Government official directed [a company lawyer], to 'approach an employee interview as if he were a prosecutor'—a request with which [the lawyer] complied by giving his 'word.'").
18. *Id.* at *6 ("Deutsche Bank's counsel sought the Government's 'permission' to interview Gavin Black, who still worked at the Bank, for a fourth time—which is to say, Deutsche Bank *asked the Government for 'permission' to interview its own employee*." (emphasis in original)).
19 *Id.* at *7 (internal alterations omitted).
20. *Id.* at *8. Although it was extremely costly, Judge McMahon also recognized that the investigation was a "conspicuous success for Deutsche Bank." *Id.* Principally, Deutsche Bank secured a DPA with the DOJ, paid a monetary penalty and retained a corporate monitor for three years. *Id.*

Cooperation can also be costly in that it can place companies in conflict with other applicable laws, especially in the case of companies with operations outside of the United States. Cooperation—and in some cases, even basic compliance with government subpoenas or requests for information—can expose companies to liability under foreign blocking statutes. For example, Switzerland has a blocking statute that prohibits taking or facilitating activities on Swiss territory on behalf of a foreign authority.[21] The penalties for violating the Swiss statute can include both monetary penalties and imprisonment.[22] And in 2018, the People's Republic of China ("PRC") enacted a blocking statute of its own, which requires approval by PRC governmental authorities before any organization or individual within the PRC can provide evidence or assistance to foreign countries' criminal proceedings.[23]

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As a general matter, companies nearly always decide to cooperate with the government's investigations of them because cooperation often yields substantial benefits, such as reduced penalties or charges and favorable forms of settlements. In addition, companies often choose cooperation out of a recognition that the government may seek disclosure of all the building blocks (in the form of documents and testimony) on which a case can be built, even if it cannot force cooperation. In the final section of this article, we discuss when a company should self-report to the government in the event that it uncovers wrongdoing.

III. WHEN SHOULD A COMPANY VOLUNTARILY SELF-REPORT THE FINDINGS OF AN INTERNAL INVESTIGATION?

When a company detects potential misconduct in its workforce, it must decide whether to investigate. And if the government begins investigating the same activity, the company must decide how it will cooperate with that investigation. In the first two sections of this article, we addressed the factors that should inform those two decisions. In this final section, we address a related question: if a company discovers misconduct unknown to the government, should it proactively report its findings? Sometimes the law requires self-reporting. But more often, the company must decide by balancing costs (like the potential for ongoing regulatory scrutiny)

21. F. Joseph Warin et al., *Navigating cross-border investigations involving Switzerland*, GLOBAL INVESTIGATIONS REV. (2019).
22. *Id.*
23. *See In re Sealed Case*, 932 F.3d 915, 933 (D.C. Cir. 2019).

against benefits (like the potential for governmental leniency). We now briefly explore these factors in companies' decisions whether to self-report.

Sometimes companies are legally required to share their investigative findings. The best-known disclosure requirement comes from the securities laws, which require companies to publish all material information necessary to prevent statements relevant to their securities from being misleading.[24] If a company discovers a significant potential liability during an investigation, it may need to disclose that liability in its next public filing to avoid penalties for misleading investors about its wellbeing. Other disclosure requirements may apply: federally insured banks, for example, must notify the government when they discover a substantial basis for believing their employees helped facilitate criminal transactions.[25] Companies that receive Medicare payments must notify the government when they discover kickback arrangements connected to those payments.[26] And manufacturers must notify the government when they discover that their products may have caused serious injuries.[27]

But the decision to self-report is often discretionary, and requires a weighing of risks and benefits. Commentators have identified obvious risks: self-reporting points the government to previously unknown misconduct and, with it, the consequences that may predictably follow its exposure—ongoing scrutiny, fines, reputational damage and the prosecution of employees. If not done carefully, self-reporting may have costs in private litigation, too. Some courts have held, for example, that verbally recounting interviews to the government can waive the privileges protecting related interview notes, exposing those notes to discovery by private plaintiffs.[28] Furthermore, all investigative findings that are reported may be admissible in court, despite the rule against hearsay, because of the exception to the rule for party admissions.[29]

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24. *E.g.*, 17 C.F.R. § 240.10b-5 ("It shall be unlawful for any person . . . to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.").
25. 12 C.F.R. § 21.11(c)(1).
26. *See* 42 U.S.C. § 1320a-7k(d)(1); Medicare Program Reporting and Returning of Overpayments, 81 Fed. Reg. 7654-01, 7659 (Feb. 12, 2016).
27. *See* 21 C.F.R. § 803.50(a).
28. *See, e.g.*, *In re Banc of California Sec. Litig.*, No. SA CV 17-00118-AG (DFMx), 2018 WL 2373860, at *1 (C.D. Cal. May 23, 2018); *SEC v. Herrera*, 324 F.R.D. 258, 263–64 (S.D. Fla. 2017); *SEC v. Vitesse Semiconductor Corp.*, No. 10 CIV. 9239 JSR, 2011 WL 2899082, at *3 (S.D.N.Y. July 14, 2011).
29. *See* Fed. R. Evid. 801(d)(2)(C) (permitting the introduction of an out-of-court statement for the truth of what it asserts if that statement is "offered against an

The costs of self-reporting are often offset, however, by the probability that the government would eventually uncover any unreported misconduct—that probability may be significant in light of the strength of whistleblower incentives. The Dodd-Frank Act encourages whistleblowers to give the SEC tips by awarding them a share of monetary sanctions that result from those tips and protecting them from retaliation by their employers.[30] Since those incentives took effect in 2011, the number of tips has grown by 74%.[31] In 2019 alone, whistleblowers provided 5,212 tips and claimed $141,976,223 in award money.[32] Considering this powerful force for exposure and the lack of any requirement that whistleblowers complain internally before contacting the SEC, the costs of proactively self-reporting may be less significant than they first appear.

Self-reporting may also benefit a company in certain situations. Reporting misconduct proactively rather than reactively may enhance the company's credibility—with the government and, if applicable, the public—and thereby help manage the scope of any follow-up investigation and the scale of any reputational damage. Proactivity may also moderate the government's view about appropriate resolutions and penalties. For example, the DOJ follows a formal system of amnesty—a set of criteria that, if satisfied, protects a company from prosecution—for companies that self-report certain kinds of misconduct. The DOJ will not prosecute a company that reports an antitrust conspiracy before others do,[33] or reports misconduct under the Foreign Corrupt Practices Act ("FCPA"),[34] so long as that company cooperates fully with DOJ investigators and meets certain other criteria.

Other sorts of leniency are available to self-reporting companies, too. The DOJ considers voluntary disclosure a mitigating factor that, even if it does not produce amnesty, may count favorably in the outcome offered to a company for disclosed misconduct.[35] A company that reports misconduct under the False Claims Act, for example, may secure clemency

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opposing party" and "was made by a person whom the party authorized to make a statement on the subject").

30. *Whistleblower Program*, SEC (Aug. 12, 2011), https://www.sec.gov/spotlight/dodd-frank/whistleblower.shtml.
31. SEC, WHISTLEBLOWER PROGRAM 2019 ANNUAL REPORT TO CONGRESS 22 (2019).
32. *Id.* at 22, 28.
33. *See* DOJ, FREQUENTLY ASKED QUESTIONS ABOUT THE ANTITRUST DIVISION'S LENIENCY PROGRAM AND MODEL LENIENCY LETTERS 2 (2017).
34. *See* U.S. DEP'T OF JUSTICE, JUSTICE MANUAL § 9-47.120 (2018).
35. *See id.* § 9-28.900.

from the damages multiplier and civil penalties available under the Act.[36] Similarly, the SEC and the Office of Foreign Assets Control ("OFAC") may respond to self-reporting by declining to bring an enforcement action, narrowing charges, or reducing penalties.[37]

But in calculating the benefits of self-reporting, as in calculating the costs, a company must proceed thoughtfully. In order to qualify for leniency when reporting FCPA misconduct, for example, a company must pay back the full amount of money made through the misconduct—a sum that may be quite significant and, in certain cases, equivalent to the likely value of a settlement in the event of prosecution.[38] And a company that details an antitrust conspiracy risks the possibility of not being the first to report, in which case the leniency available for that conspiracy is dramatically diminished.

Additionally, when multiple authorities have jurisdiction over discovered misconduct, the benefits of self-reporting must be considered in light of the ways all those authorities might address the misconduct. By reporting sanctions violations to OFAC, for example, a company may mitigate penalties in civil-enforcement proceedings, but it may not avoid criminal prosecution by the DOJ. And by reporting FCPA violations to the DOJ, a company may mitigate the risk of U.S. prosecution, but it may not avoid prosecution by foreign authorities. The risk of duplicate punishment may be moderated in certain cases by policies encouraging coordination between authorities with coordinate jurisdiction, but those policies may not promise favorable outcomes. The Justice Manual's "piling-on" policy, for example, merely prompts DOJ prosecutors to work with other authorities on collective results that vindicate the "interests of justice"; so if a company secures a non-prosecution agreement from another agency that DOJ prosecutors think unduly generous, they may choose to bring their own charges.[39] Article Four of the Convention on Combatting Bribery offers similarly equivocal guidance, encouraging signatories with coordinate jurisdiction over a bribery case to "consult" one another about

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36. *Department of Justice Issues Guidance on False Claims Act Matters and Updates Justice Manual*, DOJ (May 7, 2019), https://www.justice.gov/opa/pr/department-justice-issues-guidance-false-claims-act-matters-and-updates-justice-manual.
37. *See* Andrew Ceresney, *The SEC's Cooperation Program: Reflections on Five Years of Experience*, SEC (May 13, 2015), https://www.sec.gov/news/speech/sec-cooperation-program.html; *OFAC FAQs: General Questions*, U.S. DEP'T OF THE TREASURY (Feb. 6, 2019), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx.
38. *See* U.S. DEP'T OF JUSTICE, JUSTICE MANUAL § 9-47.120 (2018).
39. *See id.* § 1-12.100.

the appropriate way forward.[40] The calculations of a sophisticated company should incorporate the risk that guidelines like these could be construed unfavorably and result in penalties from multiple quarters.

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In sum, the decision whether to report the findings of an internal investigation depends on a series of judgments about the way general legal standards—disclosure rules, leniency rules, coordination rules—work in practice. While the law provides a guide, the ultimate decision is one for the company and its board of directors, considering the best interests of the shareholders and how to maximize those interests in the event of a future government enforcement action.

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40. *See* Convention on Combating Bribery of Foreign Officials in International Business Transactions art. 4, Dec. 17, 1997, S. Treaty Doc. No. 105-43, 37 I.L.M. 1.

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