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YOU CAN BEAT THE CRIME, BUT YOU CAN'T BEAT THE RIDE: WHAT CORPORATIONS NEED TO KNOW BEFORE AN INVESTIGATION

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by

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Butler, Snow, O'Mara, Stevens & Cannada, PLLC

The title to this CONTEMPORARY LEGAL NOTE is an old saying among prosecutors and law enforcement officers. What does it mean? Even if you are never convicted of a crime, you are going to have to go through the process of being arrested, bonding out of jail, and defending yourself, and don't forget paying all of the legal bills. Then, you face all of the civil suits that will surely follow in today's corporate world. You just took the ride.

Rather than avoiding conviction, the ultimate goal is to never be charged. This is especially true in the corporate world. Even the hint of an investigation can send stocks plummeting and customers fleeing. Forget about shutting down the publicity. Only publicity which is "arbitrary, capricious and unreasonable or for the purpose merely of bringing pressure to bear upon those involved in administrative or judicial proceedings" will be subject to an injunction.[1] You won't win that skirmish.

What follows is a broad overview, primarily focused on corporations, to help avoid the possibility of the ride. We will strive to provide information on protecting your company and its employees from the risk of an investigation and, if possible, the filing of resulting criminal charges.

[1] *See Silver King, Mines, Inc. v. Cohen*, 261 F. Supp. 666, 674 (D. Utah 1966).

I. PROTECTING YOURSELF FROM INVESTIGATION

A. Corporate Compliance Program

Recent directives within the Department of Justice make clear that a great deal of importance is placed on the presence and depth of a corporate compliance program.[2] If you do not have a compliance program in place, immediately begin to develop one. Without such a program, the government will view you as an entity which is not interested in preventing raud and criminal conduct. The government will assume that you acquiesced in or even knew of the criminal conduct. You can find specific guidance on creating and implementing a compliance program from different federal agencies in regulations and on their websites.[3]

Looking to the introductory comments to the Sentencing Guidelines utilized for sentencing corporations and companies reveals that tolerance of criminal activity will increase the ultimate punishment. On the other hand, the existence of an effective compliance and ethics program will mitigate the ultimate punishment.[4] Section 8B2.1 of the Guidelines emphasizes the federal government's intolerance of high-level personnel claiming ignorance of criminal conduct by specific employees. This policy is displayed by the prosecution of Richard Scrushy, Bernard Ebbers, and others. The Guidelines provide that high-level personnel and the governing authority shall be familiar with the compliance program and shall be informed by lower-level personnel of the effectiveness of the program.[5] This compliance program also should ensure that due diligence reveals individuals who

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[2]United States Sentencing Commission, *Guidelines Manual*, Chapter Eight-Sentencing Organizations (Nov. 2004); Memorandum of Deputy Attorney General Larry D. Thompson to Heads of Department Components (Jan. 20, 2003).

[3]*See e.g. Department of Health and Human Services, Office of Inspector General, IOG Supplemental Compliance Program Guidance for Hospitals*, 70 Fed. Reg. 4858 (January 31, 2005) and http://www.oig.hhs.gov.

[4]USSG, Chapter Eight-Sentencing Organizations, Introductory Commentary.

[5]USSG § 8B2.1(b)(2)(A)-(C).

should not be trusted with important functions within the company because they have committed illegal acts or other bad conduct.[6] The Guidelines state:

> After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.[7]

This section of the Guidelines does not require specifically that the conduct be reported to the appropriate authorities; however, such reporting is contemplated in considering a corporation's cooperation, as will be discussed in further detail later. The commentary to the Guidelines provides that a compliance program should be commiserate with the size of the organization.[8]

In a similar vein, be aware that a company may be held responsible for violations of other acquired companies committed prior to the acquisition or merger. Thus, due diligence inquiries associated with mergers and acquisitions must explore the possibility of any type of regulatory or criminal violation.[9] Beyond facing criminal sanctions for actions you did not undertake, there could be SEC violations under the Sarbanes-Oxley Act if you certify company reports that do not reflect the criminal liabilities of the newly acquired company.[10]

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[6] *Id.* at § 8B2.1(b)(3).

[7] *Id.* at § 8B2.1(b)(7).

[8] *Id.* at 8B2.1.

[9] Robert A. Shapiro, *Mergers, Acquisitions and Due Diligence in International Trade*, METRO. CORP. COUNS., May 2004 at 23, col. 1; Edward L. Rubinoff, Lars-Erik A. Hjelm, and Thomas J. McCarthy, *Successor Liability in Enforcement Actions Involving International Trade Laws*, METRO. CORP. COUNS., May 2003 at 16, col. 1.

[10] International Trade Practice Group, *International Trade Due Diligence in Mergers & Acquisitions: Mechanisms To Avoid Liability Under U.S. International Trade Laws,* METRO. CORP. COUNS., Oct. 2004 at 5, col. 1.

B. Attorney Client Privilege/Attorney Work Product

The attorney client privilege is not a shield in the corporate criminal arena; rather, it is only a windbreaker. The better practice is to anticipate that anything a corporate client communicates to an attorney, and vice versa, ultimately may be disclosed to the government in a corporate investigation. Always keep this in mind, especially when communicating in writing. The following are circumstances under which the government may obtain information that you expected to be privileged information.

1. Crime Fraud Exception

In discussing with your attorney any facts that may relate to possible criminal conduct within your organization, be aware that the discussion is subject to subpoena by the government, forcing your attorney to file a motion to quash on privilege grounds. The motion to quash the subpoena may cause the government to respond with the "crime fraud" exception to the privilege. For this exception to apply, generally the government must make a prima facie showing that: 1) the client was engaged in or planning a criminal or fraudulent scheme, and the advice of counsel being sought furthered that scheme, and 2) the documents containing the privileged materials bear a close relationship to the client's existing or future scheme to commit a crime or fraud.[11] Application of the crime fraud exception to the attorney client privilege does not require a showing that the attorney was aware of the illegality.[12] The U.S. Court of Appeals for the Fourth Circuit has stated:

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[11] *In Re: Grand Jury Proceedings #5 v. Under Seal, Defendant*, 2005 WL 563970 (4th Cir. Mar. 11, 2005).

[12] *Id.*

> ...we found that the government's prima facie evidence of fraud vitiated both the attorney-client privilege and the fact work product privilege when the attorneys at issue unknowingly furthered the fraud.[13]

In order for the government to overcome the *opinion work product privilege*, the court stated that the government must present only prima facie evidence that the client was engaged in, or contemplating, fraudulent conduct at the time of consultation with the attorney. [14] The showing of fraud to be made by the government is basically the same in all of the federal circuits; however, there is a difference among the circuits in the standard of proof required for the evidence of fraud, ranging from more than a mere allegation to sufficient proof.[15]

2. Waiver as Cooperation with the Government

In January 2003, then Deputy Attorney General Larry Thompson issued what has come to be known as the "Thompson Memo".[16] The Thompson Memo is a guide for the Department of Justice in the prosecution of business organizations. In considering whether or not to prosecute a business organization, the memo states that a prosecutor should consider the business organization's willingness to cooperate.[17] The Memo considers cooperation by corporations to include waiver of the attorney-client and

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[13] *Id.* (citing *In Re: Grand Jury Proceedings, Thurs. Special Grand Jury Session Sept. Term,* 1991, 33 F.3d 348 (4th Cir. 1994)).

[14] *Grand Jury Proceedings #5,* 2005 WL 563970.

[15] Leo Cunningham and Erin J. Holland, *The Crime-Fraud Exception After Fifteen Years of United States v. Zolin,* 2005 A.B.A. CLE PUB. White Collar Crime.

[16] Memorandum of Deputy Attorney General Larry D. Thompson to Heads of Department Components (Jan. 20, 2003).

[17] *Id.*

work product privileges.[18]

In other words, the government may conclude that a party has not cooperated if the party has not waived both privileges. Linda Chatman Thomsen, recently named the SEC Director of the Division of Enforcement, has stated that the SEC seeks to obtain after-the-fact investigative reports, but not the legal advice received by companies under investigation regarding the investigation. In an attempt to ally fears, she added, "[w]hen an entity decides not to waive [privilege] for whatever reason, we work hard not to punish."[19] If you have nothing to hide from the government, waiver may not be a problem. However, be aware that once you waive your privileges with the government, even if you enter into a confidentiality agreement, you probably have waived those privileges with respect to the whole world, including and especially to plaintiffs in civil complaints against your company for the matters being investigated. The basic principle is that if you disclose the content to a third party, including the government, you have waived the privileges.

A recent ruling by a district court in California held that an internal investigation by a company, voluntarily given to the government, should be disclosed to former employees of that company even though there was a confidentiality agreement between the company and the government.[20] The government had opposed disclosure to the employees who were being tried in a criminal case. The court found that the attorney-client privilege did not apply because the disclosure to the government indicated that the company

[18] *Id.*

[19] Time Reason, *The Limits of Mercy*, CFO MAGAZINE, Apr. 11, 2005.

[20] *U.S. v. Bergonzi,* 216 F.R.D. 487 (N.D. Calif. 2003), *appeal dismissed as moot,* 403 F.3d 1048 (9th Cir. 2005).

did not intend for the communication to remain confidential.[21] Even though the court found that the documents fell within the work product privilege, since the court was not satisfied that the company and the government shared a common interest, the privilege was waived.[22] Ultimately, the company conceded that the documents could be used by the former employees at their criminal trial, and the issue became moot.[23] Several federal circuits similarly have concluded waiver just as the federal district court in California did,[24] with the remaining circuits yet to address this issue head on.[25]

3. *Sarbanes-Oxley*

Above, we discussed the ways in which a client may lose the benefit of confidential communications to their attorneys. With the enactment of the Sarbanes-Oxley Act and its implementing regulations, attorneys now have the opportunity to disclose privileged communications without the client's consent. This practice appears extraordinary but, nevertheless, the provision must be considered.

The regulations require counsel representing an issuer[26] to report a material violation to the chief legal officer, or to both the chief legal officer and the chief executive officer.[27] If that officer does not respond appropriately, that attorney then must report the violation to the audit committee, another committee composed of the board of directors, or the board of directors.[28] This requirement includes outside counsel hired to

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[21]*Id.* at 494.
[22]*Id.* at 495.
[23]*U.S v. Bergonzi*, 403 F.3d 1048 (9th Cir. 2005).
[24]*See In re Columbia/HCA Healthcare Corporation Billing Practices Litigation*, 293 F.3d 289 (6th Cir. 2002).
[25]*See* Kara Altenbaumer-Price, *Assessing Risks of Sharing Internal Investigations; Target Firms Cooperating with Government Risk Waiving Their Privilege,* 27 NAT'L L. J. 28 at S1, Col. 1 (Mar. 21, 2005).
[26]*See* SEC Practices Rule,17 C.F.R. § 205.2(h) (2005) (defining Issuer).
[27]SEC Practices Rule, 17 C.F.R. § 205.3(b)(1) (2005).
[28]SEC Practices Rule, 17 C.F.R. § 205.3(3)(i)-(iii) (2005).

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conduct an investigation of reported material violations.[29] Notably, though, counsel may report, without the client's consent, privileged and confidential information to the SEC to prevent a material violation, to prevent perjury, or to rectify the consequences of a material violation.

C. Internal Investigations

If you discover a possible fraud or misconduct by an employee, should you report it to the authorities immediately or conduct an internal investigation first? Either choice is fraught with danger. Since going to the authorities without all of the facts is risky, the better course may be to conduct an internal investigation. In doing so, you must consider first whether to conduct the investigation yourself, to use the services of your regular outside counsel, or to obtain the services of an independent outside counsel.

The strongest consideration for hiring an independent outside counsel is the perception of independence from management. Independent counsel can look at the problem without predisposed conceptions of both the actors involved and the potential outcome. We believe that it is important to bring in an investigative team that includes people with prior criminal experience. The stakes today are too high to risk treating a potential criminal matter as though it was merely a potential civil lawsuit or claim.

An internal investigation obviously includes interviewing officers and employees. Before starting the investigation, you need to decide how to handle employees who either may or may not be willing to cooperate with management and the persons doing the investigation. Some companies have attempted to avoid later employee problems by having in place a policy imposing as a mandatory condition of employment that all employees cooperate with management during an internal investigation.

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[29] *Id.* at (5).

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Two issues with employees arise during an internal investigation. First, the employee must be advised, prior to interview, that the attorney conducting the interview represents the company, *not* the employee, and that the results of the interview are not privileged and possibly may be provided to the authorities as a result of a pledge of cooperation. Second, the employee should be advised that he or she faces possible criminal liability if their cooperation is not truthful.

An example of the second issue is the case of Ira Zar, who served as the Chief Financial Officer of Computer Associates International, Inc. (CA). Mr. Zar found himself charged by the SEC because he "made, or caused to be made, materially false and misleading statements or omissions to CA's outside auditors in connection with their audits of CA's financial statement..."[30] Furthermore, Zar allegedly made false statements to the outside counsel conducting the audit.[31] Under the Exchange Act, to directly or indirectly make or cause to be made false or misleading statements in connection with audits and reviews is a crime.[32] Even though Mr. Zar did not make statements directly to the government, the alleged false statements to the auditors and attorneys conducting the internal investigation were provided subsequently to the SEC authorities. Since employees can be charged criminally based on what they say to counsel conducting the internal investigation, before an interview, every employee should be reminded that counsel does not represent the employee — they represent the company — and that whatever the employee says to the investigative counsel is not privileged, may be provided to the government, and thus must be truthful.

An employee that does not want to cooperate with company counsel

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[30]Complaint filed by the SEC in *SEC v. Zar*, 04 Civ. 1463 (I.L.G.), paragraph No. 44.

[31]*Id.* at paragraph No. 35.

[32]Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2; SEC Practice Rule, C.F.R. §

also may be recalcitrant when the government starts asking questions. As mentioned earlier and illustrated in the AIG case, such conduct may be the subject of a company policy covering both government and internal company investigations. American International Group (AIG) fired two top executives for not cooperating with authorities. AIG had a company policy that required employees to cooperate with government authorities on matters pertaining to the company.[33]

After conducting an internal investigation, you and your counsel may find the need to present the results to the appropriate regulatory or prosecutorial authorities. The internal investigation may help convince the appropriate authorities that there is no need to seek criminal charges against the business entity. But in revealing your investigative efforts, you have opened the company up to sharing everything with the government which then may be provided to other parties, as mentioned previously. A possible course of conduct is for the attorney conducting the internal investigation to write the results of the investigation as if the whole world will view it at some point in the future.

What exactly does the SEC consider as "cooperation" when it comes to internal investigations? In a press release announcing the prosecution of three former Homestore Inc. executives, the SEC stated that:

> ...[I]t would not bring any enforcement action against Homestore because of its swift, extensive and extraordinary cooperation in the Commission's investigation. This cooperation included reporting its discovery of possible misconduct to the Commission immediately upon the audit committee's learning of it, **conducting a thorough and independent internal investigation, sharing the results of that investigation with the government (including not asserting any applicable privileges and protections with respect to written materials furnished to the Commission staff)**, terminating responsible wrongdoers, and

240.13b2-2 (2005).

[33]Business Briefs, THE NEWARK, N.J. STAR-LEDGER at 66, Mar. 23, 2005.

implementing remedial actions designed to prevent recurrence of fraudulent conduct.[34]

As far as the SEC is concerned, this says it all. Give up everything and everybody, the good, the bad, the ugly, and the company just may avoid prosecution. At least one of the federal agencies, the Department of Health and Human Services (HHS), has formalized their requirement of internal investigations in regulations.[35] The regulation calls for voluntary self-disclosure by providers participating in health care programs and provides guidelines for conducting the internal investigation.[36] In summary, the investigation must address: (1) the nature and extent of the improper or illegal practice, and (2) the circumstances surrounding discovery of the practice and the health care provider's efforts to stop the inappropriate conduct, including any disciplinary action taken against the corporate official, employees, or agents as a result of the discovery. Regarding the governmental cooperation expectation discussed at various times in this article, please note that this particular regulation ends with emphasis on voluntary production of all relevant information and documents "...without the need to resort to compulsory methods."[37] Furthermore, "lack of cooperation will be considered an aggravating factor when the OIG assesses the appropriate resolution of the matter," the term "resolution" including the explicit threat of referral to the Department of Justice for criminal sanctions.[38]

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[34]SEC Files Financial Fraud Case Charging Three Former Homestore Executives; Defendants Agree to Repay $4.6 Million in Illegal Trading Profits, Exchange Act Release No. 2002-141, Sept. 25, 2002 [emphasis added].

[35]*Office of the Inspector General (OIG), HHS, Publication of the OIG's Provider Self-Disclosure Protocol,* 63 Fed. Reg. 58399 (Oct. 20, 1998).

[36]*Id.*

[37]*Id.* at 58403.

[38]*Id.*

II. PROTECTING YOURSELF DURING AN INVESTIGATION

A. The Government Contacts You

If you receive a call or a visit from a federal investigator or prosecutor, you should direct them to your attorney. Be pleasant, but refer them to your attorney. Do not discuss anything with them and do not allow them to look informally at any documents or speak with any of your employees without first speaking with your attorney. After they speak with your attorney, hopefully you will have an idea of what they are looking for and why. Your company may not be the target of the investigation. Whoever is speaking with the authorities needs to ask questions. Specifically, ask if you are the target of the investigation. At least one court has overturned a conviction when federal authorities misled an individual about the purpose of seeking records.[39]

If the authorities suspect a company employee of fraud or criminal behavior, the company should cooperate to the fullest extent. The Department of Justice (DOJ) guidelines are clear that the main consideration in deciding whether to charge a business entity is the "authenticity of a corporation's cooperation."[40]

If a company does find itself indicted and subsequently convicted, cooperation is a mitigating factor when it comes to punishment as well.[41] So, what is non-cooperation? The DOJ will consider:

> ...whether the corporation, while purporting to cooperate, has engaged in conduct that impedes the investigation (whether or not arising to the level of criminal obstruction). Examples of

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[39] *See U.S. v. Tweel*, 550 F.2d 297 (5th Cir. 1977) (overturning a conviction for tax evasion when an IRS agent misled an individual's accountant as to the nature of an audit.)

[40] Memo of Larry D. Thompson (Jan. 20, 2003).

[41] United States Sentencing Commission, *Guidelines Manual*, Chapter Eight-Sentencing Organizations, Introductory Commentary (Nov. 2004).

> such conduct include: overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.[42]

You may be thinking that all of these examples clearly evidence bad conduct and your company would never commit such conduct. However, for zealous prosecutors, honestly forgetting about additional files can constitute incomplete or delayed production of records. We cannot stress enough the importance of handling any request by the government as the most serious matter facing the business and requiring the use of all necessary resources.

If the government is conducting a routine inspection, as is often the case with OSHA, e.g., and you have all of your ducks in a row, then you should allow them entry to inspect and conduct their routine investigations. However, if it appears that the business entity is a target of an investigation from the start, you may want to insist on the government following the letter of the law. In that event, the government will have to resort to a variety of discovery vehicles, including administrative subpoenas, grand jury subpoenas, or in the worse case scenario, a federal search warrant. Does this mean, though, that the government will consider that you are not cooperating? At that early stage, probably, particularly if they are forced to resort to a search warrant.

Once the government contacts you or you become aware of their interest in the company, do not do anything out of the ordinary that possibly could be seen as obstruction of their investigation, regardless of whether you are producing documents willingly or you are insisting on subpoenas. In the

[42]Memo of Larry D. Thompson (Jan. 20, 2003).

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case against Arthur Andersen, in considering whether the firm obstructed justice through a document destruction policy, the Fifth Circuit stated:

> …[t]here is nothing improper about following a document retention policy when there is no threat of an official investigation, even though one purpose of such a policy may be to withhold documents from unknown, future litigation. A company's sudden instruction to institute or energize a lazy document retention policy when it sees the investigators around the corner, on the other hand is more easily seen as improper.[43]

Although the Supreme Court reversed the Fifth Circuit's decision in *Arthur Andersen* because of the jury instructions, the firm still may be found, in a new trial to have contemplated a "particular official proceeding in which those documents might be material" when persuading others to shred them.[44]

To knowingly destroy documents with the intent to ***impede*** agency investigations is a serious felony, as witnessed with the recent enactment of 18 U.S.C.A. § 1519 as part of the Sarbanes-Oxley Act. The Supreme Court in the *Andersen* case criticized the jury instructions given by the court at the request of the government for excluding the word "dishonestly" in its definition of "corruptly" and for including the word "impede."[45] The Court noted that the definition of "impede" was so broad that "anyone who innocently persuades another to withhold information from the Government 'get[s] in the way of the progress of' the Government."[46] So, the new statute, 18 U.S.C.A. § 1519, contains the very language in the jury instructions which concerned the Supreme Court in *Andersen*.

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[43] *U.S. v. Arthur Andersen, LLP*, 374 F.3d 281, 297 (5th Cir. 2004), *rev'd on other grounds*, *Arthur Andersen v. U.S,* 125 S. Ct. 2129 (2005).
[44] *Arthur Andersen v. U.S.* 125 S. Ct. 2129 (2005).
[45] *Id.*
[46] *Id.* at 2136 (quoting Webster's definition of impede).

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B. The Government Knocks on Your Door with a Warrant

If the government comes to your business and serves a search warrant, you can request that they wait until your attorney can arrive, but don't expect them to accommodate that request. Your best bet is to ask the agents politely to explain the terms of the search warrant, ask them what they are seeking, direct them to the location, and get out of the way. Then call your attorney and advise him or her of the situation.

To prevent havoc in the office offer to help the agents in their search. There will be a supervisory agent present. Ask that agent if you may follow the searching agents and either copy any documents they intend to seize, or at the very least, to make a note of what is being seized. Do not be surprised if your request is declined. Also, do not be surprised if they ask you to stay out of the way until they leave. But don't panic at either of those probable occurrences. The agents will leave an inventory of all items seized pursuant to the search warrant.[47]

Uncle Sam may be investigating your company or business for various reasons — an investigation prompted by a False Claims Act whistle-blower or just the FBI following up a tip from a competitor. What you need to remember is that the piece of paper in your hand is an order signed by a federal judge who already has made a determination that there is probable cause to believe that an offense has occurred and that evidence of the offense is within your premises. This is neither the time nor place to voice a contest of the warrant or the presence of the searching agents. That opportunity comes later.[48] An attempt at contest by you likely will be considered by the agent as an act of obstruction and by the judge as contemptuous.

A seizure of documents may effectively shut down, or at least hamper,

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[47]FED R. CRIM. P. 41(f)(2).
[48]FED. R. CRIM. P. 41(g)-(h).

further operations of the business. In these situations, your attorney may apply to the court for return of property under Rule 41(g) of the Federal Rules of Criminal Procedure. This application, in the form of a motion, can be made even if the search is valid. The relief being sought is the ability to reference and utilize information reflected on the seized documents to continue operation of the ongoing vital functions of the business. In effect, you are: (1) telling the court that access to the seized documents is necessary for the business to continue to function, and (2) asking the court to require the federal government either to provide you with a copy of the documents, or allow you to copy those documents.[49] Courts are prone to accommodate such requests so long as there is an indicia of good faith in the request.

There are federal agencies that have specific powers by statute to conduct investigations, including entry on premises. Here are some to be aware of:

1. Occupational Safety and Health Administration

Federal statute allows the Occupational Safety and Health Administration, or OSHA, to enter any workplace to inspect and investigate.[50] A representative is entitled to accompany the investigator on his tour through the workplace.[51] OSHA may demand access to records, inspect the records, and interview employees. You may be asking yourself, can OSHA do all of this without a warrant or a subpoena based on probable cause issued by a judge? On its face, that is how the statute reads. However, courts have construed the statute as requiring a warrant if an employer refuses entry in order to protect the employer's Fourth Amendment rights to protection against unreasonable searches.[52] Be aware, however, that OSHA

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[49]*See In re Search of the Office of Tylman*, 245 F.3d 978 (7th Cir. 2001).
[50]29 U.S.C.A. § 657(a) (2005).
[51]*Id.* at § 657(d).
[52]*See Marshall v. Barlow's Inc.,* 436 U.S. 307 (1978); *Donovan v. Federal Clearing*

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may obtain a warrant based on less evidence than the probable cause standard applied in criminal investigations. They may obtain a warrant simply based on their administrative plan to inspect an industry.[53] They also are not required to get a warrant when entry is refused by a closely regulated industry.[54] Even if a company consents to an inspector's entry, the inspection must be conducted at a reasonable time, within reasonable limits, and in a reasonable manner.[55]

2. Department of Transportation

Under the Motor Carrier Safety Act, the Department of Transportation (DOT) may subpoena witnesses and records relating to an investigation.[56] In addition, the statute states:

> [t]he Secretary [of DOT], or an employee (and, in the case of a motor carrier, a contractor) designated by the Secretary, may on demand and display of proper credentials- (1) inspect the equipment of a carrier or lessor; and (2) inspect and copy any record of- (A) a carrier, lessor, or association; (B) a person controlling, controlled by, or under common control with a carrier, if the Secretary considers inspection relevant to that person's relation to, or transaction with, that carrier; and (C) a person furnishing cars or protective service against heat or cold to or for a rail carrier if the Secretary prescribed the form of that record.[57]

3. Federal Energy and Regulatory Commission

The Federal Energy and Regulatory Commission (FERC) has general

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Die Casting Co., 655 F.2d 793 (7th Cir. 1981).

[53] *See Marshall v. Barlow's Inc.* at 320-21; *Erie Bottling Corp. v. Donovan*, 539 F. Supp. 600 (W.D. Pa. 1982); *Matter of Establishment Inspection of Trinity Industries, Inc.*, 898 F.2d 1049 (5th Cir. 1990), *rehearing denied.*

[54] *See Marshall v. Barlow's Inc.* at 313.

[55] *See* 29 U.S.C.A. § 657(a) (2005); *L.R. Wilson and Sons, Inc. v. Occupational Safety & Health Review Com'n*, 134 F.3d 1235 (C.A. 4 1998), *cert. denied, Herman v. L.R. Wilson & Sons, Inc.*, 525 U.S. 962 (Nov. 2, 1998).

[56] 49 U.S.C.A. § 502(d) (2005).

[57] *Id.* at § 504(c).

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investigative powers to issue subpoenas and examine witnesses.[58]

4. Securities and Exchange Commission

According to the Securities and Exchange Commission's (SEC) website, "[e]ach year the SEC brings between 400-500 civil enforcement actions against individuals and companies that break the securities laws."[59] Congress was liberal in granting the SEC the power to investigate potential violations of the securities laws by legislating that:

> The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is ***about*** to violate any provision of this chapter, the rules or regulations thereunder, . . . and may require or permit any person to file with it a ***statement in writing, under oath*** or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized in its discretion, to ***publish*** information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates.[60]

The SEC may subpoena witnesses and documents. If their subpoena is refused, they may go to court to enforce the subpoena.[61] "Commission enforcement proceedings may be summary in nature . . .".[62] Therefore, "[a]n evidentiary hearing is not required in the absence of a meaningful and

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[58]42 U.S.C.A. § 7171(g) (2005).

[59]Introduction-The SEC: Who We Are, What We Do, at http://www.sec.gov/about/whatwedo.shtml.

[60]15 U.S.C.A. § 78u(a)(1) (2005).

[61]*Id.* at § 78u(c).

[62]*SEC v. Knopfler*, 658 F.2d 25 (2d Cir. 1981) (citing *SEC v. First Security Bank of Utah*, 447 F.2d 166, 168 (10th Cir. 1971), *cert. denied*, 404 U.S. 1038 (1972)).

substantial factual showing."[63]

Preliminary investigations generally are done by SEC staff. However, if facts and circumstances indicate potential enforcement action, the Commission may resort to a Formal Order of Investigation.[64] This order may be sent to the target of the investigation.

Pursuant to the Sarbanes-Oxley Act, the SEC now is charged with inspecting registered public accounting firms to make sure they are complying with the new Act. Unlike the general SEC investigative statute, if you do not cooperate with investigators under Sarbanes-Oxley, they can suspend or bar you from "being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;" or "suspend or revoke the registration of the public accounting firm…"[65]

In addition, under Sarbanes-Oxley, individuals may be forced to give up bonuses and compensation if there is an accounting restatement.[66] Sarbanes-Oxley also allows the SEC to petition the court for an order to escrow extraordinary payments during the course of an investigation.[67] The Ninth Circuit recently held that multi-million dollar termination payments paid to two former executives were extraordinary payments and could be held in escrow pending the SEC investigation.[68]

The SEC allows targets of investigations to file what is known as a "Wells submission"[69] in response to contemplated charges. When a party is notified that charges are recommended, often by a "Wells notice", defense counsel may request a "Wells meeting" during which the SEC staff presents

[63]*Id.* (citing *SEC v. Howatt*, 525 F.2d 226, 229 (1st Cir. 1975); *U.S. v. Newman*, 441 F.2d 165, 169 (5th Cir. 1971)).
[64]Marvin Pickholz, SEC Crimes, § 2:4 (Dec. 2003).
[65]15 U.S.C.A. § 7215(b)(3)(A)(i)-(ii) (2005).
[66]*Id.* at § 7243.
[67]*Id.* at § 78-u3(c)(3)(A)(I).
[68]*See SEC v. Gemstar-TV Guide International, Inc.,* 401 F.3d 1031 (9th Cir. 2005).
[69]New York lawyer John A. Wells chaired the SEC Advisory Committee on

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a detailed account of the facts supporting the contemplated charges. After the meeting, the target may file a Wells submission, responding to the government presentation. This is considered a writing under oath in the previously quoted statutory language. Be aware, though, that Wells submissions may not only be used against the party who is the subject of the investigation, but also may be discoverable to other parties.[70]

5. Internal Revenue Service

The Internal Revenue Code authorizes Internal Revenue Service (IRS) agents designated with the duty of enforcing criminal, seizure, or forfeiture provisions of the Code to function basically as the equivalent of any other law enforcement officer. They can carry firearms, execute search warrants, and make arrests without a warrant.[71] They can and do conduct undercover investigative operations on a grand scale.[72]

6. Federal Trade Commission

The enforcement statute of the Federal Trade Commission (FTC), while authorizing examinations and subpoenas,[73] also requires that the government notify a target of the purpose of the investigation as follows:

> Any person under investigation compelled or requested to furnish information or documentary evidence shall be advised of the purpose and scope of the investigation and of the nature of the conduct constituting the alleged violation which is under investigation and the provisions of law applicable to such violation.[74]

Enforcement Policies and Practices that initially recommended this practice.

[70]*See In Re: Initial Public Offering Securities Litigation,* 2004 WL 60290 (S.D.N.Y. 2004) (holding that Wells submissions were relevant and discoverable in a suit brought by investors against underwriters of initial public offerings).

[71]26 U.S.C.A. § 7608 (a)-(b) (2005).

[72]*Id.* at § 7608 (c).

[73]15 U.S.C.A. § 49 (2005).

[74]15 U.S.C.A. Chapter 2 of Subchapter 1 § 2.6 (2005).

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7. *Food and Drug Administration*

The Federal Food, Drug, and Cosmetic Act requires the Food and Drug Administration (FDA) to send notice to a target that they are coming to inspect the premises, at which time they will expect to have access to certain records.[75] The statute does not discuss the need for a warrant. To the contrary, the statute describes refusal to permit entry as a prohibited act.[76] However, similar to OSHA, courts have construed the statute as requiring the government to obtain a warrant if the target refuses entry.[77] Of course, the agency need show no more than that reasonable administrative standards for inspection have been established and will be met in the inspection in question.[78]

8. *Department of Health and Human Services*

The Department of Health and Human Services (HHS) derives investigatory power from the Inspector General Acts and the Social Security Act.[79] In 1977, the Secretary of the then-Department of Health, Education and Welfare merged the Social Security Administration's Investigative Branch into the Department's Inspector General's (OIG) Office of Investigations (OI).[80] Deputized OI agents have law enforcement capabilities to make arrests and enforce search warrants. The OIG is authorized to exclude health care providers from participation in Medicare and other federal health care programs if they submit false claims to Medicare under the False Claims Act or commit other bad acts.[81] In

[75] 21 U.S.C.A. § 374 (2005).

[76] *Id.* at § 331f.

[77] *See U.S. v. Thriftmart, Inc.,* 429 F.2d 1006 (9th Cir. 1970), *cert. denied,* 91 S. Ct. 188, *rehearing denied,* 91 S. Ct. 453.

[78] *Id.* at 1008-1009.

[79] 5 U.S.C. App. § 6 (2005); 42 U.S.C.A. § 405(d) (2005).

[80] Genevieve Nowolinski, *A Brief History of the HHS Office of Inspector General* (June 2001).

[81] 42 U.S.C.A. § 1320a-7 (2005).

addition, the Attorney General is authorized to issue administrative subpoenas during the course of an investigation relating to a Federal health care offense.[82]

The Secretary of HHS is charged with enforcement of the Health Insurance Portability and Accountability Act (HIPAA).[83] In carrying out this function, the Secretary may conduct non-public investigational proceedings where testimony is taken under oath. Covered entities face possible civil monetary penalties as well as criminal penalties. Notably, DOJ has issued an opinion that only institutions and in conjunction their employees under an agency theory will be prosecuted under the criminal enforcement provision of HIPAA, not individuals acting on their own.[84]

During the course of an investigation of health care fraud by a physician, the government often seeks peer review documents of that physician. Most states recognize a peer review privilege but federal circuits have different tests to determine whether a peer review document is discoverable pursuant to a government subpoena.[85]

9. Federal Reserve/Financial Crimes Enforcement Network

By law, the Board of Governors of the Federal Reserve System are authorized to examine "accounts and affairs of banks", "[t]o suspend or remove any officer or director of any Federal reserve bank", and to suspend operations of or liquidate or reorganize banks.[86]

Under the Right to Financial Privacy Act, the government must

[82] 18 U.S.C.A. § 3486 (2005).

[83] 42 U.S.C.A. § 1320a, *et seq.* (2005).

[84] Op. Off. Legal Counsel (June 1, 2005) on Scope of Criminal Enforcement Under 42 U.S.C. § 1320d-6.

[85] *See In Re: Administrative Subpoena Blue Cross Blue Shield of Massachusetts, Slip Copy,* 2005 WL 1801694 (D. Mass. July 28, 2005); *U.S. v. Lazar, M.D., Slip Op.,* 2005 WL 1921139 (W.D. Tenn. July 29, 2005).

[86] 12 U.S.C.A. § 248(a), (f) & (h) respectively (2005).

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reimburse financial institutions for the reasonable costs of producing records with some exceptions.[87] This provision is unique to financial institutions. Usually, a subpoena will contain a provision that the institution notify the government in advance if costs will be incurred above a specified amount. A financial institution may appeal the decision to deny reimbursement costs to federal district court.[88]

The Financial Crimes Enforcement Network (FinCEN) administers the Bank Secrecy Act (BSA) which requires banks and casinos to report suspicious activity (SARs).[89] Of course, what constitutes "suspicious activity" is subjective. So, examiners are instructed to focus on the policies, procedures, and processes in place to identify suspicious activity when reviewing bank accounts.[90] Decisions not to report a transaction must be documented in great detail and the decision to prosecute a bank under the BSA requires approval by the Main Office of the Department of Justice.[91] Financial institutions are prohibited from disclosing whether a SAR has been filed or any of the information contained therein[92] and the actual SAR itself is deemed confidential and privileged.[93] Financial institutions must be aware that while they must be vigilant to protect themselves from penalties imposed by the federal government for not filing a SAR, they may face civil liability from customers for disclosing account information without a good faith basis or pursuant to a government oral request.[94]

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[87] 12 U.S.C.A. § 3415 (2005).

[88] *See In re Grand Jury Proceedings* (5th Cir. 1981).

[89] 12 U.S.C.A. § 5313 (2005); 31 C.F.R. 103.21 (2005).

[90] Bank Secrecy Act Anti-Money Laundering Examination Manual (July 2005).

[91] Remarks by FinCEN officials at BSA Conference in New York, New York August 22, 2005.

[92] 12 C.F.R. § 353.3(a) (2005).

[93] 12 C.F.R. § 261.2 , 261.22 & 353.3(g) (2005).

[94] *See* Alan Cohen, Julie Copeland, and Scott Schrader, *Corporate Brief; Financial Crime; Disclosure Requirements*, 22 NAT'L .L.J. 43 (June 19, 2000).

C. Subpoenas

1. Grand Jury

During the course of an investigation, the government may resort to a grand jury investigation with subpoenas for documents and persons to testify. Quashing a grand jury subpoena is difficult, and there is no right to appeal a denial of a motion to quash a grand jury subpoena.[95]

The better course is to put your best foot forward and for your company to cooperate truthfully, fully, and promptly, particularly in responding to requests for documents. Once a grand jury investigation commences, a number of potential problems and issues come to the forefront, including attorney client privilege assertions, potential officer/employee culpability and independent counsel, joint defense agreements, the Thompson Memo, electronic discovery, and parallel proceedings by the regulatory agencies involved, to name a few.

If any officers/employees of the company, are required to testify before the grand jury, please make sure that all documents, especially including e-mails, are made available for review prior to the appearance. This is not the time for the employee witness to be guessing at events when the government prosecutor is standing there with a document or e-mail that directly controverts the guess of the witness. Before the grand jury, the employee is alone. Counsel cannot accompany the witness before the grand jury.

Federal grand jury proceedings are transcribed by an official court reporter, but the witness will not be given a copy. If you want to know what happened before the grand jury, you will have to resort to interviewing the witness after the grand jury session and trusting his or her best recollection

[95]*See U.S. v. Ryan*, 402 U.S. 530, 532 (1971); *SEC v. ESM Government Securities, Inc.*, 645 F.2d 310 (5th Cir. 1981).

of the questions and answers. Only when the criminal proceedings are resolved finally will the possibility of obtaining the transcript arise. Please note the term "possibility." There are provisions within the federal grand jury rule for petitions to require the government to disclose testimony under certain limited circumstances.[96] However, if you do manage to be successful in your quest for grand jury information, be aware that if you have a transcript in your possession, at least one federal court has ruled that that transcript is discoverable in other related actions.[97]

2. *Administrative Subpoenas*

If you get an administrative subpoena from a federal agency, your only hope of quashing the subpoena is to show that it did not comply with statutory and regulatory rules. To quash for an invalid purpose is a high hurdle to jump.[98] For example, in the case of the SEC,

> A recipient of an SEC subpoena may refrain from complying with it, without penalty, until directed otherwise by a court order. *See Donaldson v. United States*, 400 U.S. 517, 523-25, 91 S.Ct. 534, 538-39, 27 L.Ed.2d 580 (1971). [ ] A court will not enforce an SEC subpoena directed at the target of an investigation unless the agency, at an evidentiary hearing, demonstrates that it has complied with the requirements of *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964). These are that (1) the agency has a legitimate purpose for the investigation; (2) the inquiry is relevant to that purpose; (3) the agency does not possess the information sought; and (4) the agency has adhered to administrative steps required by law. *Id.* at 57-58.[99]

[96]FED. R. CRIM. P. 6(e)(3)(E)(i) & 6(e)(3)(F).

[97]*See LaMorte v. Mansfield*, 438 F.2d 448 (2d Cir. 1971).

[98]*See SEC v. Knopfler*, 658 F.2d 25 (2d Cir. 1981) (holding that opponent of subpoena issued by the SEC on ground that subpoena is sought for invalid purpose must prove that improper purpose established is that of the Commission not one of its investigators, and burden may not be met by presentation of conclusory allegations); *SEC v. ESM Government Securities, Inc.*, 645 F.2d 310 (5th Cir. 1981) (holding that fraud, deceit or trickery are grounds for denying enforcement of an administrative subpoena).

[99]*Jerry T. O'Brien, Inc. v. SEC and Magnuson v. SEC,* 704 F.2d 1065, 1067 (9th Cir.

A target of an investigation may intervene to challenge a subpoena directed to another party that affects the target but only with the court's permission.[100]

Be aware that an administrative subpoena may not be used to gather evidence against a defendant once the issuing agency refers the case to the Department of Justice for criminal charges.[101]

3. *Right to Financial Privacy Act*

The government must follow specific rules when obtaining by subpoena financial records of a customer of a financial institution.[102] These rules are codified in the Right to Financial Privacy Act, 12 U.S.C.A. § 3401 *et seq.* When issuing an administrative or judicial subpoena (other than grand jury subpoenas), the government must certify in writing to the financial institution that it has complied with the applicable provisions of the statute before the institution can release records.[103]

When the government wants to serve an administrative subpoena or summons or a judicial subpoena (other than grand jury) on a financial institution, the customer is entitled to notice of the subpoena. A copy of the subpoena or summons must be served upon or mailed to the customer on or before the date on which the subpoena or summons is intended to be served on the financial institution, including a notice that states the ***nature of the***

1983), *reversed and remanded on other grounds*, *SEC v. Jerry T. O'Brien, Inc.,* 467 U.S. 735 (1984).

[100]*Id.*

[101]*See U.S. v. Lazar, M.D., Slip Copy*, 2005 WL 1921139 (W.D. Tenn. July 29, 2005); *U.S. v. LaSalle National Bank*, 437 U.S. 298 (1978).

[102]*See Hunt v. SEC*, 520 F. Supp. 580 (N.D. Tex. 1981) (holding that individuals were entitled to an injunction against the SEC under the Financial Right to Privacy Act where the SEC's violations of the Act, such as failure to include a complete copy of the original subpoena with the customer notices and failure to notice the customers of the subpoena seeking the testimony of a former officer of the financial institution, were clear and convincing.)

[103]12 U.S.C.A. § 3403(b) (2005).

law enforcement inquiry and the customer's right to oppose such production of their records.[104]

The government can apply to the appropriate court for delayed notice to the customer if the notice will result in endangering persons, flight from prosecution, tampering with evidence, intimidation, or jeopardizing or delaying the investigation.[105] Other exceptions to application of the notice requirement include, for example, regulatory functions, litigation involving the customer, and more importantly, with the usual Department of Justice investigation, the all powerful grand jury subpoena.[106] Similarly, the SEC may have access to financial records of a customer without notifying the customer upon an *ex parte* showing to a district court that notification will result in flight from prosecution, tampering with evidence, the transfer of assets outside the United States, improper conversion, or impeding their ability to investigate.[107]

With respect to grand jury subpoenas, as a general rule (subject to some exceptions), a financial institution may not notify the customer that a subpoena has been received for that customer's records.[108] Any notification to the customer of the existence of a grand jury subpoena by any employee of the financial institution is considered obstruction of justice.[109]

D. Position Papers

If the government is contemplating possible charges against an entity, the prosecutors usually will entertain a request by the target to persuade the prosecutors either that civil disposition of the allegation is appropriate rather than criminal action, or that a lesser criminal charge can resolve the

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[104] *Id.* at § 3405(2) & 3407(2).
[105] *Id.* at § 3409(a).
[106] *Id.* at § 3413.
[107] 15 U.S.C.A. § 78u(h) (2005).
[108] 12 U.S.C.A. § 3420 (2005).
[109] 18 U.S.C.A. § 1510 (2005).

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controversy. While discussions between corporate counsel and government counsel routinely take place during the investigative phase, corporate counsel may find a written submission to be advantageous. A position paper may persuade government counsel to focus on the written recitation of weaknesses in the government's theory and of strengths in the company's position. Additionally, there now will be a recordation in the government's file of the company's assessment of the applicable law and the pertinent facts for potential reference in the future.

E. Proffers

During the course of an investigation, certain individuals within the company may be asked by the federal prosecutors to give a proffer. In a proffer, the potential witness would state what they know about the facts surrounding the investigation. The purpose of the proffer, insofar as the individual is concerned, is to seek immunity in exchange for the requested information and potential testimony. The prosecutor most likely will resist immunity and counteroffer a lesser charge or a favorable sentencing recommendation, or both.

This is different than a typical defense lawyer conversation with the prosecutor about an individual's case. The proffer is an informal statement by the individual, usually by interview, that may be used in court to impeach that individual's testimony. The problem and resulting danger with the proffer is that it can be used against the individual if they do not receive immunity and later are forced to take their case to trial as a result of indictment.[110] If criminal culpability is unclear, the best course may be for the individual's attorney to approach government counsel to gauge whether the government would be favorable to immunity in the first place. A proffer

[110] *See* Jane Anne Murray, *Proffer at Your Peril*, Andrews WHITE-COLLAR CRIME REP. (July 28, 2005).

without a grant of immunity is good only for the government and may have a silencing effect on the defense of the charges, if such becomes the case.

An individual should never lie in a proffer as it defeats the whole purpose. More importantly, the individual may be prosecuted for lying during the proffer, under either an obstruction of justice statute or for making false statements to the government.

F. Deferred Prosecution Agreements

A number of the recent major corporate responsibility investigations have been resolved with deferred prosecution agreements (DPAs). The essence of this procedure is in the designation. Prosecution of the company is deferred for the period of time that the prosecutors and regulatory agencies believe will satisfy deterrent goals, implementation of specific compliance programs, modification of corporate management personnel, execution of restitution agreements, and/or any of a myriad of government goals in addressing evils discovered in corporate administration. Extremely large fines have been the norm with DPAs. In the worst case scenario, a requirement of public acceptance of responsibility by the company, including agreement to a detailed statement of facts, has been the norm.

With a DPA, the government achieves its goal of retribution and deterrence, and the company is spared the expense and embarrassment of daily media exposure of potential corporate dirty laundry revealed in bitter, protracted, and expensive litigation. Since DPAs are public records and generally are based on an agreed statement of facts, corporate counsel should pay close attention, not only for publicity concerns, but also for future litigation claims by victims or investors. While corporate counsel will strive for advantageous provisions in the DPA, such as a promise not to prosecute company officials and employees or provisions that regulatory agencies will not restrict the future business, the highly publicized corporate

responsibility cases indicate that boards of directors and stockholders just want the bloodletting of the investigation concluded as soon as possible.

CONCLUSION

With the introduction of the Sarbanes-Oxley Act and the allure of taking down titans of industry, the criminal world encroaches on the corporate civil world now more than ever. When your in-house counsel decided to practice civil law in the business world, he or she probably gave little thought to crime or "the ride." Now, companies with sizeable assets must consider potential criminal ramifications arising out of the various organizational functions.

Management/human resources, accounting, audit, financial statements, marketing, shipping, product identification, and services rendered are all subject to review by one or more regulatory agencies. A short hop from there is the criminal justice system, with special agents and prosecutors ready to start you on the ride. Do not underestimate the potential impact of a failure to address issues, large or small, past, present, and future, that can and do arise in the everyday administration of a business.

Treat any federal or state regulator's inquiry or for that matter any internal irregularity as a potential criminal matter from the start. Do not take the posture that the situation can be treated as just a civil discovery request or a potential civil lawsuit. According to the current government mindset, a prompt response with complete and correct information should be the practice. Remember that you make a felony conviction much easier to obtain by the government if acts constituting cover up and obstruction of justice are committed.

Media coverage in the past several years has described numerous

occasions in which authorities have prosecuted corporate officials for the cover up, where the substantive conduct by the target was regarded as a civil matter, and administrative and grand jury subpoenas as civil discovery requests. Shredding documents to manipulating financial statements has been described as part of the cover ups. The question becomes, would a loss of a bonus for one year or even a civil law suit by investors for loss of profits be preferable to years in prison and loss of all assets as in the case of executives and managers of WorldCom[111] or decimation of the business as in the case of Arthur Andersen or Enron? You can afford the loss of a bonus, but you cannot afford the ride or the crime.

[111]Jerry Mitchell, *Ebbers offers millions*, THE CLARION-LEDGER, July 1, 2005; Ana Radelate, *Judge: Punishment fits crime*, THE CLARION-LEDGER, July 14, 2005.

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