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The 'Upjohn' Pitfalls Of Internal Investigations

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MOST OUTSIDE COUNSEL conducting internal investigations of corporate clients begin employee interviews by advising the individual that (i) the lawyer represents the company and not the employee and (ii) the interview is privileged but the privilege belongs to the company, which can decide to waive it and disclose the contents of the interview at any time.

But the level of detail of these so-called "Upjohn warnings,"[1] named after the U.S. Supreme Court decision upholding the privilege to the company when individual employees are questioned by the company's lawyers, often vary, given competing considerations. The investigating lawyer must attempt to balance the need to disclose potential conflicts of interest to the employee with the desire to conduct the interview and obtain information that could be critical to the investigation.

Two recent actions, one stemming from the options backdating investigation at Broadcom Corporation and the other involving the SEC investigation of Stanford Financial Group, highlight the pitfalls that even very experienced counsel may encounter. While on closer examination the central issue in both cases was the application of traditional conflict of interest principles, the matters nevertheless provide useful guidance for lawyers navigating these areas.

This article begins by discussing the wide range of Upjohn warnings currently in use, then describes the Broadcom and Stanford situations, and concludes by offering suggestions for both in-house and outside counsel conducting employee interviews where there are parallel government investigations and civil litigation, as frequently is the case.

The Range of Upjohn Warnings

When an issue or problem that might require an investigation arises, corporate executives are likely to turn first to the general counsel or another senior in-house lawyer to recommend actions to be taken to protect the company's interest.

The lawyer receiving that call typically will make initial inquiries to determine whether outside counsel needs to be retained, and, if so, whether regular counsel can be used or whether special or independent counsel needs to be employed.[2]

Chances are the in-house lawyer will not find it necessary to remind executives or other employees that she represents the corporation, nor will she warn

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them that the corporation may choose to disclose any information provided to her to regulators or criminal authorities.[3] Regular outside counsel may be more likely than internal counsel to warn employees that counsel represents the company and not any individual, but regular counsel may be hesitant to begin a discussion with senior executives with whom they have had a long relationship with such a formal warning.

Nearly all special counsel retained to conduct an internal investigation, on the other hand, will begin their interviews of the corporation's employees with some form of Upjohn warning. Even then, the contents of the advisory can vary widely.

It may be as simple as a statement that the interview is privileged, that the company expects the employee to keep any information discussed during the interview confidential and that the company will have sole discretion to decide whether to waive the privilege and disclose the contents of the interview. In other situations, special counsel may advise the employee that he may or should retain his own counsel; in certain situations that the company will provide counsel for the employee should he so choose; that the company has decided or is very likely to waive the attorney-client privilege and that the employee should assume that any information provided to counsel will be disclosed to the government.

In some cases, investigating attorneys have gone so far as to expand these warnings, with the caution that lying to the attorneys conducting the investigation may be considered the equivalent of lying to the government and is a crime;[4] and that the employee has the right not to be interviewed, although refusing to cooperate could lead to termination of employment. And some special counsel will go so far as to require the interviewee to sign a written acknowledgement that the Upjohn warnings were given.

Lessons From Broadcom

The Broadcom investigation demonstrates the perils that can occur when regular outside counsel steps in to conduct an internal investigation that may implicate senior management with whom the lawyers have had longstanding relationships.

Broadcom is a technology company that designs and sells semiconducters for wired and wireless communications. In the spring of 2006, it was identified as among the group of companies that may have historically issued "backdated" stock options to employees, that is, issuing options dated "as of" an earlier date when the stock price was lower, so that the option strike price was set at a price less than the market price of the company's stock on the date the options were in fact issued.

To prepare for potential government regulatory and/or criminal investigations as well as inevitable civil litigation, Broadcom turned to its long-time outside counsel, Irell & Manella LLP, to conduct an internal investigation into the company's stock options granting practices.

Irell had represented Broadcom for more than a decade, since before the company's initial public offering, and some of those assignments also involved representing the company's senior executives. For example, from 2002 to 2005, Irell defended Broadcom and certain executives in securities litigation.

Of even greater significance, shortly after the backdating investigation commenced, Broadcom and its executives were sued in a class action and a derivative action, and Broadcom again turned to Irell to represent both the company and the individuals in those actions. One of the Broadcom executives who had been a defendant in the first securities litigation and was a defendant in the class action and derivative action arising from the alleged backdating, was the company's chief financial officer, William Ruehle. Irell represented Mr. Ruehle, as well as Broadcom, in all three of those actions.

Even **very experienced** counsel may get into trouble, as shown by two **recent** actions, one involving the SEC investigation of **Stanford Financial**, the other from the **Broadcom** options backdating investigation.

Against this backdrop, in June 2006, two litigation partners at Irell interviewed Mr. Ruehle about Broadcom's historical stock option granting practices. Although there is some factual dispute whether the Irell lawyers provided any Upjohn warning to Mr. Ruehle in connection with the internal investigation interview, the lawyers acknowledged that they did not advise him that they would no longer serve as his lawyers in the civil litigation, and in fact they continued to represent him in the civil litigation for another two months. In August 2006, at Broadcom's direction, Irell disclosed the substance of Mr. Ruehle's interview to the company's auditors, Ernst & Young, and to the Securities and Exchange Commission, which was conducting an investigation of Broadcom.

Mr. Ruehle claimed that he first learned that the disclosure had been made by Irell in December 2008, after he had been charged criminally with securities fraud for his role in the options backdating at Broadcom. In required discovery in the criminal case, he received from the government FBI memoranda that contained his statements. Mr. Ruehle promptly moved to suppress the statements on the ground that they were protected by the attorney-client privilege and had improperly been disclosed to the government by Irell.

On April 1, 2009, the U.S. District Court for the Central District of California issued an order concluding that the statements made by Mr. Ruehle during the interview were privileged because Irell was Mr. Ruehle's counsel at the time and that Mr. Ruehle expected and reasonably believed that his statements to his counsel would remain confidential. Accordingly, the court suppressed the statements and precluded them from being used in the criminal trial.

But the court went further. It found that Irell had an attorney-client relationship with Mr. Ruehle, had breached the duty of loyalty owed to him, and had clearly violated the ethical obligations owed to its client. The court concluded:

> Irell's ethical breaches of the duty of loyalty are very troubling.… The Rules of Professional Conduct are not aspirational. The Court is at a loss to understand why Irell did not comply with them here. Because Irell's ethical misconduct has compromised the rights of Mr. Ruehle, the integrity of the legal profession, and the fair administration of justice, the Court must refer Irell to the State Bar for discipline. Mr. Ruehle, the Government, and the public deserve nothing less.[5]

Stanford Financial

Similar confusion concerning whether outside counsel was representing a corporate executive individually led to a recent malpractice action being filed against the law firm of Proskauer Rose and one of its litigation partners.[6]

Laura Pendergest-Holt was the chief investment officer of the Stanford Financial Group, the collection of financial entities controlled by Allen Stanford and allegedly operated as a massive, $9 billion Ponzi scheme. In or about February 2009, the SEC sought Ms. Pendergest-Holt's testimony in connection with its investigation of the Stanford Group.

According to her, she believed that Proskauer was retained to represent her in connection with the SEC proceedings. She claimed this belief was reinforced by counsel's representation on the record during her SEC testimony that "I represent her insofar as she is an Officer or director of one of the Stanford affiliated companies."

At the same time, according to her complaint, Proskauer was negotiating to be retained by the Stanford Group and/or Stanford individually. Thus, she alleged, she never was advised that the firm did not represent her, that she should retain her own individual counsel, that she had the right not to testify before the SEC, that she faced potential criminal penalties, that as a result she should not testify, that her interests were opposed to those of the Stanford Group and that counsel was conflicted

in advising her because of its interest in representing the Stanford Group.

Pendergest-Holt claimed that she was inadequately prepared for her testimony and that counsel had failed to show her documents to refresh her recollection about events she would undoubtedly be questioned on during her testimony. As a result, Ms. Pendergest-Holt alleged that she testified before the SEC, following which she suffered the freezing of her assets and being wrongly charged with a crime.

The malpractice case ultimately was dismissed without prejudice by the plaintiff, without any determination or finding of wrongdoing by the firm. Nonetheless, it is yet another example of the scrutiny that counsel may face, in hindsight, whether with or without merit, in their dealings with corporate executives during their representation of companies under investigation by the government.

Practice Recommendations

The question remains whether these two high profile actions against prominent law firms, a recommendation for disciplinary action by a federal judge and a malpractice case, should cause different or more elaborate practices with respect to Upjohn warnings in connection with internal investigations. A number of observations are in order.

First, if counsel is going to represent the company and the individual, one must be sure that there is no actual or likely conflict. It bears emphasis that the view at one moment may change swiftly in the future. Hence, the representation decision must be carefully evaluated, including the potential use of a separate "conflicts counsel" to confirm the multiple representation decision.

The situations where such representation most likely will be all right are probably those where there is some form of group pleading of wrongdoing and not associated with specific or individual conduct. If there is doubt or uncertainty about the ability to represent both clients, it is far preferable for the individual to obtain separate counsel.

Second, in evaluating the proper course, counsel must keep in mind prior instances of representation of individuals or groups. This is important not only for successive representation issues, but also to analyze how the individual employee will be likely to understand the relationship and to comprehend the nature of corporate representation.

Third, it is important to balance the fact that while the individual needs to understand the difference between representing the company and representing the employee, not every interview creates a conflict that necessitates separate representation. Especially with lower level employees and with those whose conduct is not likely to be under scrutiny, an overly robust Upjohn warning may be counterproductive and frighten the employee from cooperating.

With these considerations in mind, some guidelines for counsel to consider are as follows.

• Internal counsel should carefully evaluate whether they need to give Upjohn warnings to their internal contacts when consulting on a potential issue or conducting an initial inquiry to determine whether outside counsel needs to be retained. Obviously, the more substantive the interview, and the greater the involvement of the officer in question, the greater the likelihood that Upjohn warnings are in order. This is all the more difficult because of prior existing relationships that may cause confusion on the part of the employee.

Once a decision has been made that the matter is sufficiently serious that outside counsel is required, internal counsel would be well-served to remind their colleagues that they represent the corporation and not any employee individually.

• Regular outside counsel are in a potentially precarious position when investigating the conduct of senior executives of the company with whom the firm has had a long relationship, and in most circumstances both the lawyers and the client would be well-advised instead to retain special counsel that is independent or less involved with senior management. If regular counsel nevertheless conducts the investigation or does initial interviews to advise whether special counsel should be brought in, the regular counsel must take extra precaution to ensure that they do not have current or related past attorney-client relationships with any of the employees whose conduct might be at issue, including in litigations where the firm represented both the company and the individuals as employees of the company.

At a minimum, consideration should be given to retaining "shadow counsel" to advise the employees, either individually or as a group, i.e., counsel with no prior ties to the company whose job is to advise the individual and stand at the ready to assume the representation in its entirety if needed. The engagement letter with shadow counsel should clearly define the scope of the retention and interaction with the company's regular counsel, and can prove crucial in a subsequent dispute challenging simultaneous representation by the company's counsel.

Any joint defense agreement between the company's counsel and shadow counsel should clearly provide that the employee will not disclose the company's privileged information but that the company may disclose any information provided to it.

• Special counsel conducting an internal investigation should always begin interviews of company employees with an Upjohn warning that advises that the interview is privileged and that the privilege belongs to and can be waived by the company. Special counsel should consider whether any heightened warning, such as that a memorandum summarizing the interview is likely to be provided to the government or that the employee can elect not to be interviewed, is necessary or appropriate.

• In many circumstances, it would assist in developing an accurate factual record and would improve employee morale for the company to provide and pay for counsel for employees being interviewed in the investigation (the same lawyer can often represent groups of similarly situated employees who do not have conflicts with one another) and to provide counsel with the employee's relevant documents in advance of the interview. The company and its counsel should consider whether these steps are appropriate or beneficial, as well as the cost of providing counsel and/or documents, on a case-by-case basis.

Conclusion

There is not a single approach to giving Upjohn warnings during internal investigations that is right in all circumstances. Instead, counsel conducting investigations need to consider the specifics of each matter, as well as the different backgrounds of the employees interviewed during each investigation, and adopt a flexible approach that effectively balances the competing considerations of obtaining accurate information, having the ability to cooperate effectively with the government if that is in the company's best interest, and protecting the rights and morale of employees who did not engage in wrongdoing, all the while avoiding ethical miscues.

1. *Upjohn Co. v. United States*, 449 U.S. 383 (1981), established that the attorney-client privilege and work-product protection extended to the attorney's review of facts to determine which were legally significant.

2. The decision whether to involve regular counsel or to engage special counsel may depend on a variety of factors: the seriousness of the underlying allegations and the potential scope of the investigation; whether a special committee of the Board of Directors will be formed to conduct the investigation; the existence of government investigations or the likelihood that such investigations will occur; and the existence of other litigation.

3. This observation is based upon the in-house counsel's familiarity with employees, especially senior officers of the company. However, in-house counsel also is subject to the same ethical/conflict strictures as outside counsel and the better practice would be for internal counsel not to undertake a probing interview of other employees without the requisite warning. See Model Rule 1.13(f) ("In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing").

4. *United States v. Kumar*, Case No. 1:04-CR-846-ILG (E.D.N.Y. Sept. 20, 2004) (former chief executive officer and chief financial officer of Computer Associates were indicted, and former general counsel pleaded guilty, to obstruction of justice for lying to and providing false documents to counsel conducting internal investigation of company).

5. *United States v. Nicholas*, Case No.: SACR 08-00139-CJC, Order Suppressing Privileged Communications, April 1, 2009, at 18.

6. *Pendergest-Holt v. Sjoblom*, Case No. 3:09-CV-00578-L (N.D. Tex. March 27, 2009).