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PITFALLS OF ATTEMPTS TO COOPERATE WITH ENFORCEMENT AGENCIES

A Company Attempting to Gain Credit for Cooperating with a Government Investigation Must Satisfy the Government with Its Disclosures and Admissions but Also Protect Itself against Private Litigation. The Tension Between These Two Aims Raises Issues of Privilege Waivers, Counsel Retention, and Evidence Preservation. The Second of a Two-Part Article.

By Hector Gonzalez and Claudius O. Sokenu *

Part I of this article explored the "carrot and stick" approach to the role of cooperation that is pervasive in the current enforcement environment, in which government agencies tend to reward those who cooperate, and punish those who do not.[1] Although cooperation yields many benefits, including the potential to avoid prosecution and minimize financial penalties, lawyers for corporations and other business organizations nevertheless should proceed with caution. In this second part, we explore the pitfalls and difficulties that may arise when a corporation attempts to gain credit for cooperation with government enforcement agencies.

How, for example, should a corporation limit the possibility that an employee's statements made to company counsel in the course of an internal investigation might provide the basis for that employee's indictment on obstruction of justice charges? On April 9, 2004, Ira Zar, the former chief financial officer of Computer Associates International, Inc., pleaded guilty

[1] Hector Gonzalez and Claudius O. Sokenu, *The Current Enforcement and the Corporate Response*, Vol. 40, No. 9 The Review of Securities & Commodities Regulation [p. no. 99-114] [May 2, 2007][hereinafter *Gonzalez I*].

*HECTOR GONZALEZ is a litigation partner in the New York office of Mayer, Brown, Rowe & Maw LLP and a former Assistant United States Attorney in the Southern District of New York. His e-mail address is hgonzalez@mayerbrownrowe.com. CLAUDIUS SOKENU is a litigation partner in the same office and a former senior counsel with the Securities and Exchange Commission, Division of Enforcement, in Washington, DC. His e-mail address is csokenu@mayerbrownrowe.com. *The authors wish to thank Paula Garrett Lin, an associate in the same office who worked diligently on this article.* *The views expressed here are those of the authors and do not necessarily reflect the views of the firm or any of its clients.*

IN THIS ISSUE

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to securities fraud, conspiracy to commit securities fraud, and conspiracy to obstruct justice, based on allegations that he and other officers and executives engaged in a scheme to fraudulently report fiscal quarter revenues by artificially extending months for accounting purposes, and to conceal this practice from outside auditors.[2] According to the government, Zar provided false justifications for the illegal accounting practices "to the [c]ompany's [l]aw [f]irm and the [a]udit [c]ommittee's [l]aw [f]irm knowing and with the intent that they would, in turn, be presented to the United States Attorney's Office, the SEC, and the FBI."[3] The government based its obstruction of justice charge, not on representations by Zar to the United States Attorney's office, but rather on Zar's communications with lawyers employed by Computer Associates and its audit committee.

And how does a corporation ensure that its internal investigation's findings are acceptable to the government? The SEC's reaction to an internal investigation into allegations of fraudulent accounting practices at Symbol Technologies illustrates the problem, and points to a possible solution.[4] In that case, the SEC notified Symbol Technologies that the Commission had received an anonymous letter containing allegations of fraudulent transactions. Symbol Technologies hired one of its regular outside law firms to investigate.[5] The law firm concluded that no accounting fraud had occurred. When the SEC expressed its dissatisfaction with the investigation, Symbol Technologies hired a law firm with which it had no longstanding relationship. During the second investigation, Symbol Technologies dismissed a senior vice president of finance who was deemed to be a ringleader in obstructing the investigation, agreed to share the substance of its interviews with current and former employees and customers with the government, made witnesses available to the government, and produced hundreds of thousands of documents and e-mail communications. Based on the manner in which the second investigation was conducted, the SEC settled with the company. Twelve executives were charged with accounting fraud, and the Department of Justice announced that it would not charge the company with criminal wrongdoing.[6]

The Zar case and the Symbol Technologies investigation are just two examples of how well-intentioned corporations can find themselves in trouble because of the way their internal investigations are conducted. This article will discuss these and other pitfalls of which corporations and their counsel must be aware when cooperating with government investigations.

WAIVING PRIVILEGES

There is no question that enforcement entities still value waivers of attorney-client privilege and work product protection. For example, as discussed in Part I of this article, the highly publicized Thompson Memorandum encouraged prosecutors to consider waiver of corporate attorney-client privilege and work product protection in evaluating a corporation's cooperation.[7] And, although the McNulty Memorandum limits the circumstances under which prosecutors should seek waivers, it does not prohibit rewarding voluntary waivers.[8] Both the SEC's Seaboard Report and other

[2] *See* Kenneth N. Gilpin, *Guilty Pleas in Computer Associates Case*, INT'L HERALD TRIB., Apr. 9, 2004, at 11; *see also* Information ¶¶ 10-17, at 5-9, United States v. Ira Zar, Cr. No. 04-331 (ILG) (E.D.N.Y. Apr. 8, 2004), *available at* http://www.usdoj.gov/dag/cftf/chargingdocs/zarinfo.pdf [hereinafter Zar Information].

[3] Zar Information, *supra* note 2, ¶ 33.

[4] *See* Andrew Longstreth, *In the New Era of Internal Investigations, Defense Lawyers Have Become Deputy Prosecutors*, 27 AM. LAW. 68 (Feb. 2005).

[5] *Id.*

[6] Longstreth, *supra* note 4. *See also SEC v. Symbol Technologies*, Lit. Rel. 18734 (June 30, 2004).

[7] *Gonzalez I, supra* note 1, at 105; *see also* Larry D. Thompson, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm, § II(A)(4) [hereinafter Thompson Memorandum].

entities with enforcement capabilities, including the NYSE, also encourage waiver. [9]

Voluntary disclosure of protected information, however, is fraught with pitfalls. Among the most serious of these is that, even when a confidentiality agreement is in place, the results of the internal investigation may provide a roadmap to private plaintiffs' lawyers. Unless a corporation is in a jurisdiction where the selective waiver rule applies or the corporation qualifies under the Financial Services Regulatory Relief Act (which applies to insured depository institutions or credit unions and is discussed in Part I of this article), the decision of whether to waive is one that must be considered in light of all of the current and future litigation faced by the corporation.[10]

For these reasons, the decision to waive attorney-client privilege or work product protection must be approached with caution, particularly in the early days of an investigation that could take years to resolve, and that could be accompanied by third-party litigation. Where possible, counsel should cooperate fully with the government investigation while preserving the corporation's privilege.[11] In cases where it becomes necessary to disclose privileged information, a strong confidentiality agreement may be critical.[12]

INVESTIGATIONS BY CORPORATE COUNSEL

The government's obstruction of justice charge against Zar highlights the lengths to which the government will go to prosecute alleged securities fraud. This trend raises both ethical and legal concerns. First, counsel must remain vigilant to his or her duty as a zealous advocate for the client, and also ensure that current and former employees clearly understand that the corporation's counsel does not represent them in their individual capacity.[13] Thus, as always, counsel must give an *Upjohn* warning at the outset of an employee interview.[14]

Depending on the relationship between the government and the corporation, counsel must also consider giving a so-called Zar warning, which goes further than the *Upjohn* warning in that the employee is warned that the corporation may give the government any information the employee provides, exposing that employee to the possibility of obstruction of justice charges in the event that his or her statements are deemed to be untruthful.[15] Among the circumstances to consider when deciding whether to give a Zar warning is the fact that, in the event that the government believes the employee was not entirely forthcoming, the employees having received the warning and therefore being made explicitly aware of the possible

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[8] Paul J. McNulty, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), *available at* http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf, § VII.B.2, [hereinafter McNulty Memorandum].

[9] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, Rel. No. 34-44969 (Oct. 23, 2001), *available at* http://www.sec.gov/litigation/investreport/34-44969.htm, at n.3 [hereinafter Seaboard Report]. *But see* Commissioner Paul S. Atkins, Remarks Before the Federalist Society (Sept. 21, 2006). ("I strongly believe that the Commission should not view a company's waiver of privilege as a factor that will afford cooperation credit. . . . Maybe it is time for the Commission to revisit this issue in a formal way and to clarify that waiver o[f] fundamental rights and protections will not result in lesser allegations and/or remedies.") *See also* Memorandum from Susan Merrill, Exec. V.P., NYSE's Div. of Enforcement, to All Members, Member Orgs. and COOs, NYSE Information Memo No. 05-65 (Sept. 14, 2005), [hereinafter Cooperation Memo], *available at* http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublished InfoMemosNyseCom/85256FCB005E19E88525707 C004C6DE0/$FILE/Microsoft%20Word%20-%20 Document%20in%2005-65.pdf ("[t]he essence of cooperation is that facts relevant to an investigation must be made available to Exchange investigators, and as long as those facts are candidly and completely presented, there will be no adverse effect arising from the non-waiver of a privilege.")

[10] *See Gonzalez I, supra* note 1, at 106, 109.

[11] *See* Sheila Finnegan, THE FIRST 72 HOURS OF A GOVERNMENT INVESTIGATION: A GUIDE TO IDENTIFYING ISSUES AND AVOIDING MISTAKES 40 (Nat'l Legal Ctr. for the Public Interest, Vol. 10, No. 2, Feb. 2006).

[12] Richard A. Spehr and Claudius O. Sokenu, SEC Self-Policing Policy Presents Benefits and Pitfalls, 7 Andrews Sec. Lit. & Reg. Rep. 17 (Feb 27, 2002), at 4.

[13] *See*, *e.g.*, Model Rule of Prof'l Conduct 1.7 (governing concurrent conflicts of interests). *See also* N.Y. Code of Prof'l Responsibility DR 5-109(A).

[14] Specifically, counsel should explain to the employee that counsel represents the company, and not the employee; is interviewing the employee to give legal advice to the company; that the interview is covered by the attorney-client privilege; that the company controls the privilege; and that the company, but not the employee, may elect in the future to waive the privilege and disclose information from the interview to third parties, including the government. *See Upjohn Co. v. United States*, 449 U.S. 383, 394-96 (1981); *see also* Finnegan, *supra* note 11, at 30.

[15] Finnegan, *supra* note 11, at 32.

consequences of untruthful or misleading statements, may be put at greater risk of an obstruction charge.[16]

In addition, counsel conducting an internal investigation must guard against possible violations of employees' rights to due process and to assistance of counsel. The law is settled that a due process violation arises when a government agent obtains information from the subject of a criminal investigation by affirmatively misleading the subject regarding the criminal nature of the investigation.[17] The same rule may apply when the misleading investigator is a lawyer for the corporation doing the government's bidding.

In *United States v. Stringer*, the Oregon U.S. Attorney's Office (USAO) believed a criminal prosecution of two defendants was likely, but the SEC and USAO agreed that the criminal investigation should take a back seat to a civil investigation conducted by the SEC so as not to jeopardize the SEC's opportunity to obtain statements from the defendants and other witnesses.[18] Throughout the SEC's investigation, the USAO was in regular communication with the SEC and helped shape the substance of that investigation.

In response to the direct inquiry of a defendant's lawyer, the SEC misled the defendant about the existence of the criminal investigation. When an indictment was issued, the defendants asserted that their due process rights were violated because they were not told that the USAO and the FBI were using the SEC to gather evidence for a criminal prosecution. They claimed that, had they known, they would have sought a stay of the civil proceedings, would not have produced any documents, and one defendant would not have provided a Wells submission. The court dismissed the indictment, observing that it was a "flagrant disregard of individuals' rights to deliberately deceive, or even lull someone into incriminating themselves in the civil context when activities of an obvious criminal nature are under investigation."[19]

Although the *Stringer* case involves a long pattern of cooperation that is perhaps unlikely between prosecutors and corporate counsel, it is not difficult to imagine circumstances in which counsel for a corporation might inadvertently mislead an employee about the nature of a government investigation. Such a turn of events ultimately could result in negative consequences for the corporation, including the erosion of trust between the corporation and its employees, reduced efficacy of internal compliance programs, a diminished ability of a corporation to effectively cooperate with government investigators, and the increased potential for litigation between the corporation and its employees. Another Sixth Amendment issue is discussed in the next section.

PAYMENT OF EMPLOYEE ATTORNEYS' FEES

As Part I of this article noted, enforcement agencies may, under some circumstances, consider corporations' advancement of attorneys' fees to employees or agents under investigation and indictment as a negative factor indicating something less than full cooperation.[20]

In the KPMG case (*Stein I*),[21] KPMG conditioned payment of fees on its employees' cooperation and cut off such payments for those who had been indicted.[22] In response, the affected employees successfully moved for a dismissal of the indictment on the grounds that the government-applied pressure on the firm to cut off attorneys' fees violated their Sixth Amendment right to counsel.[23] Although KPMG's government-driven decision to cut off attorney's fees helped it get the deferred prosecution agreement it wanted, that decision led to a highly publicized judicial reprimand of the company for its policies that violated its employees' constitutional rights. Whether KPMG has suffered any lasting internal or reputational damage as a result of its

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[16] *Id.*

[17] *See*, *e.g.*, *United States v. Stringer*, 408 F. Supp. 2d 1083, 1089 (D. Or. 2006) ("[I]t is a due process violation if government agents make affirmative misrepresentations as to the nature or existence of parallel proceedings or otherwise use trickery or deceit." (citing *United States v. Robson*, 477 F.2d 13, 18 (9th Cir. 1973))).

[18] *Id.* at 1085.

[19] *Id.* at 1089 (quoting *United States v. Grunewald*, 987 F. 2d 531, 534 (8th Cir. 1993) (internal citations omitted). *See also United States v. Scrushy*, 366 F. Supp. 2d 1134, 1140 (N.D. Ala. 2005) ("[B]ecause this is a case where the government has

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undoubtedly manipulated simultaneous criminal and civil proceedings, both of which it controls, there is a special danger that the government can effectively undermine rights that would exist in a criminal investigation by conducting a de facto criminal investigation using nominally civil means. In that special situation the risk to individuals' constitutional rights is arguably magnified.") (*citing SEC v. HealthSouth Corp.*, 261 F. Supp. 2d 1298 (N.D. Ala. 2003) (internal quotations omitted).

[20] *See Gonzalez I*, *supra* note 1, at 108; McNulty Memorandum, *supra* note 8, § VII.B.3.

[21] *See United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

[22] *Gonzalez I, supra* note 1, *at 108.*

[23] *Stein*, *supra* note 21, 435 F. Supp. 2d at 365-66.

treatment of its current and former partners and employees remains to be seen.

Nonetheless, a corporation may protect itself from prosecutors' negative conclusions if it has a clear policy on the payment of fees, and a clear understanding of its legal obligations under that policy. The court in *Stein* opined that, had KPMG instituted a policy with respect to advancing attorneys' fees, the Justice Department would likely not have counted KPMG's payment of attorneys' fees against it in assessing its cooperation. Consistent with the Thompson Memorandum, the Justice Department in *Stein* repeatedly sought to learn the extent of KPMG's legal obligations to pay attorneys' fees.[24] It thereby implied "that compliance with legal obligations would be countenanced, but that anything more than compliance with demonstrable legal obligations could be held against the firm."[25] Although it was "the longstanding practice" of KPMG to pay such fees for all partners, principals, and employees of the firm in all civil, regulatory, and criminal proceedings in the scope of each individual's job duties and responsibilities, KPMG's partnership agreement and by-laws did not address the payment of such fees.[26] The murkiness of KPMG's legal obligations, combined with KPMG's desire to avoid indictment, both played critical roles in the firm's decision to withhold payment of fees.[27]

DEFERRED PROSECUTION AGREEMENTS

Part I of this article explained that deferred prosecution and non-prosecution agreements are becoming an increasingly popular method for corporations to use to avoid criminal prosecution.[28] However, these agreements almost always require that the target stipulate to the government's recitation of facts, and that the target may not contradict those facts.[29] Before it enters into such a stipulation, a corporation should consider two possible problems that stipulation may cause. First, in the event of parallel investigations and subsequent litigation, a stipulation to the government's version of the facts provides a roadmap to further liability, with little the corporation can do to defend itself. Second, any breach of these agreements – such as, for example, if the corporation fails to implement prescribed compliance procedures – will subject the corporation to prosecution. In that prosecution, the corporation is likely to be convicted because it has already stipulated to the government's recitation of the facts.[30]

SELECTION OF COUNSEL

While in-house counsel may conduct minor investigations, it may be better to retain outside counsel for more serious and complex matters. In choosing among counsel, the corporation should consider that government enforcement agencies will tend to view investigations conducted by outside attorneys without previous ties to the corporation as more credible than those conducted by regular outside counsel. For example, the SEC's Seaboard Report states that the SEC will ask: "Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel?"[31]

The Symbol Technologies case highlights the reasons why a government enforcement agency may view an internal investigation conducted by regular outside counsel with more skepticism than one conducted by an independent firm with few or no ties to the corporation.

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[24] For example, at an initial meeting with lawyers for KPMG, the government stated that it "would take into account KPMG's legal obligations, if any, to advance legal expenses, but referred specifically to the Thompson Memorandum as a point that had to be considered." *Stein*, *supra* note 21, 435 F. Supp. 2d at 341.

[25] *Id.* at 352-53.

[26] *Id.* at 340.

[27] According to the opinion, "KPMG repeatedly tried to convince the [United States Attorney's Office] not to indict the firm, touting its cooperation with the investigation and its limitation of attorneys' fees for individuals." *Stein*, *supra* note 21, 435 F. Supp. 2d at 348.

[28] *See Gonzalez I*, *supra* note 1, at 112-113.

[29] *See*, *e.g.*, *United States v. Computer Associates Int'l*, Cr. No. 04-837 (ILG), Deferred Prosecution Agreement ¶ 27

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(E.D.N.Y. Sept. 24, 2004) [hereinafter CA Deferred Prosecution Agreement] ("CA agrees that it shall not, through its attorneys, Board of Directors, agents, officers, or employees, make any public statement, in litigation or otherwise, contradicting its acceptance of responsibility or the allegations set forth in the Information or Stipulation of Facts."); *see also United States v. America Online, Inc.*, Crim. No. 1:04 M 1133 (E.D. Va.), Deferred Prosecution Agreement ¶ 3 [hereinafter AOL Deferred Prosecution Agreement]; *United States v. AIG-FP Pagic Equity Holding Corp*., Deferred Prosecution Agreement ¶ 4 (W.D. Pa. Nov. 30, 2004) [hereinafter AIG-FP Pagic Deferred Prosecution Agreement.].

[30] *See*, *e.g.*, CA Deferred Prosecution Agreement, *supra* note 29, ¶¶ 25-26; *see also* AOL Deferred Prosecution Agreement, *supra* note 29 ¶ 17-18; AIG-FP Pagic Deferred Prosecution Agreement, *supra* note 29, ¶ 4.

[31] Seaboard Report, *supra* note 9.

The government may view regular outside counsel as less willing to make difficult decisions, such as recommending discipline and/or termination of uncooperative employees, in order to obtain reliable results.[32] Other considerations include whether regular outside counsel gave legal advice regarding the transaction in question, whether regular outside counsel may be subpoenaed as a witness, and whether regular outside counsel and the corporation have a close and long-standing relationship.

SCOPE OF INVESTIGATION

An internal investigation that is too narrow may lead to inaccurate findings, or the accusation that the corporation attempted to conceal wrongdoing.[33] Both the SEC and DOJ scrutinize an internal investigation's scope. The SEC considers that scope, among other factors, in determining whether to bring an enforcement action: "Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins, and consequences of the conduct and related behavior?"[34] The DOJ will look disfavorably upon an investigation it believes has omitted relevant inquiries.[35]

To minimize the chance that the government will view an investigation's scope as too narrow, the internal investigation should mirror the government's, unless there is a reason to broaden it.[36] In addition, the investigation should thoroughly address the criteria identified in the Seaboard Report and the McNulty Memorandum, including the nature of the misconduct, how the misconduct arose, where in the organization the misconduct occurred, how long it lasted, the harm that the misconduct has inflicted upon investors and other corporate constituencies, and how (and by whom) the misconduct was detected.[37]

JOINT DEFENSE AGREEMENTS

If the interests of the corporation and management are closely aligned, counsel may choose to obtain separate representation for management and enter into a joint defense agreement between management and the corporation. Such an arrangement will achieve two objectives. First, obtaining separate counsel for management at an early stage, particularly when it is likely that the corporation's and manager's interests will diverge, avoids the need to continually reassess the propriety of joint representation (although reassessment of the propriety of continuing the joint defense agreement may become necessary).[38] Second, a joint defense agreement will facilitate the sharing of information between the corporation and its employees.

On the downside, entry into a joint defense agreement may limit the strategic options available to the corporation. The corporation may not be able to share information it has obtained from an employee with the government.[39] Moreover, the government may look unfavorably upon joint defense agreements if it appears that the corporation is using the agreement to protect its culpable employees by providing information to the employees about the government's investigation. The McNulty Memorandum teaches prosecutors that "a corporation's promise of support to culpable employees .

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[32] *See* Longstreth, *supra* note 4 (discussing Symbol Technologies case). The McNulty Memorandum specifies that corporate compliance programs should be designed, *inter alia*, to prevent and detect misconduct. McNulty Memorandum, *supra* note 8, § VIII.A. To this end, the McNulty Memorandum views disciplinary action as part of a comprehensive compliance program:

> In determining whether or not a corporation should be prosecuted, a prosecutor may consider whether meaningful remedial measures have been taken, including employee discipline and full restitution. . . . Employee discipline is a difficult task for many corporations because of the human element involved and sometimes because of the seniority of the employees concerned. . . . In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

Id. § IX.B.

[33] *See also* Finnegan, *supra* note 11, at 27.

[34] Seaboard Report, *supra* note 9.

[35] McNulty Memorandum, *supra* note 8, § VII.B.4.

[36] Finnegan, *supra* note 11, at 27.

[37] *See id.* at 28-29; Seaboard Report, *supra* note 9; McNulty Memorandum, *supra* note 8.

[38] *See* N.Y. Code of Prof'l Resp. DR 5-105 [1200.24] Conflict of Interest; Simultaneous Representation.

[39] *See United States v. LeCroy*, 348 F. Supp. 2d 375, 384-85 (E.D. Pa. 2004) (observing that company was bound by joint defense agreement and could not turn over notes and memoranda of discussions with employees to the government unless and until it withdrew from joint defense agreement); *see also* Finnegan, *supra* note 11, at 24 n.28.

. . through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."[40] Counsel therefore should weigh carefully the costs of entering into a joint defense agreement against any prospective benefits.

AMENDED EVIDENCE RULE 408

Federal Rule of Evidence 408 – regarding the admissibility of evidence of compromises and offers to compromise – has been amended to provide that the rule does not bar the introduction, in a criminal case, of statements or conduct during negotiations of a civil dispute involving a government regulatory, investigative, or enforcement agency.[41] In essence, Rule 408 will not prohibit prosecutors from introducing evidence of settlement offers made during negotiations with enforcement agencies as evidence of criminal liability.

The amendment raises an important issue for counsel considering whether to engage in settlement negotiations with the government, and should inform decisions such as whether a client should provide the SEC with a Wells submission.[42] As amended, Rule 408 will not prevent prosecutors from introducing any settlement offer contained in a Wells submission for purposes of showing liability in a criminal proceeding. Thus, it is crucial that counsel engage in civil settlement negotiations with government officials with an eye to the possibility that statements made in negotiations could resurface in a criminal trial.[43]

EVIDENCE PRESERVATION

Once a corporation has learned that it is under investigation (or even that there is the probability of an investigation), it must immediately suspend document destruction practices and avoid the destruction of relevant documents and electronic data.[44] Even the inadvertent destruction of relevant materials can result in serious consequences for a corporation that has been subpoenaed by the government, as the government is likely to investigate the circumstances of any destruction to determine whether criminal obstruction charges are appropriate.[45] Unlike other such statutes, the criminal obstruction statute contained in Section 802 of the Sarbanes-Oxley Act of 2002 criminalizes – without requiring the existence of an official proceeding – the destruction, alteration, or falsification of records.[46]

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[40] McNulty Memorandum, *supra* note 8, § VII.B.3.

[41] *See* FED. R. EVID. 408 advisory committee's note.

[42] In the Wells process, targets of SEC investigations are notified if the SEC's Enforcement Division staff decides to recommend charges, and defense counsel will then typically request a Wells meeting, at which the staff presents a more detailed account of its case. *See*, *e.g.*, *In re Initial Public Offering Sec. Litig.*, No. 21 MC 92(SAS), 2004 WL 60290, at *1 (S.D.N.Y. Jan. 12, 2004) (describing Wells process). Defense counsel may then choose to file a Wells submission, which may, *inter alia*, seek to persuade the Enforcement Division staff not to recommend an enforcement action, or to drop certain charges. *Id.* at *2. A Wells submission often includes an explicit offer of settlement with the Commission. *Id.* at *3. It has been held that voluntary submissions to the SEC are not entitled to work product protection in subsequent civil litigation. *See In re Steinhardt Partners, L.P.*, 9 F.3d 230, 236 (2d Cir. 1993).

[43] *Cf. United States v. Prewitt*, 34 F.3d 436, 439 (7th Cir. 1994) (holding, under an interpretation consistent with proposed Amended Rule 408, that Rule 408 did not prohibit the

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introduction into evidence of the defendant's statements made during civil compromise negotiations with the Securities Division of the Indiana Secretary of State).

[44] *See generally* Finnegan, *supra* note 11, at 2.

[45] A number of recent high-profile cases have involved obstruction of justice charges. *See*, *e.g.*, Press Release, U.S. Attorney, S.D.N.Y, U.S. Indicts Ex-Credit Suisse First Boston Official for Obstructing Grand Jury and SEC Investigations (May 12, 2003), *available at* http://www.usdoj.gov/usao/nys/ressreleases/May03/quattroneindict.pdf (Frank Quattrone); Press Release, U.S. Attorney, S.D.N.Y, Martha Stewart and Her Broker Indicted by U.S. Grand Jury; Stewart Charged Separately With Securities Fraud (June 4, 2003), *available at* www.usdoj.gov/usao/nys/pressreleases/June03/stewartprR222indict.pdf.

[46] *See* 18 U.S.C. § 1519. The statute states, in its entirety:

> Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

Id. Indeed, the provision is so broadly drafted "that it arguably could be applied to a company's destruction of documents years before even a civil inquiry by an agency begins as long as [the] company's activities were 'administered' by that agency and the company's intent was to cover its wrongdoing or hamper a then-only potential future investigation." *See* Abbe David Lowell & Kathryn C. Arnold, *Corporate Crime after 2000: A New Law Enforcement Challenge or Déjà Vu?*, 40 AM. CRIM. L. REV. 219, 225 (2003). By contrast, 18 U.S.C. § 1505 criminalizes obstruction of official proceedings and requires a corrupt state of mind. Notwithstanding the language

Even if the government concludes that an obstruction charge is not warranted, the inadvertent destruction of pertinent documents undoubtedly will call into question the sincerity of the corporation's efforts to cooperate.

Electronic data presents novel preservation challenges. In particular, determining where relevant electronic data exists and what must be done to preserve it can be difficult. Counsel must interview information technology employees to identify all sources of stored information, including personal computers, network drives, and materials stored under the employees' individual control, such as laptops. The difficulty of determining where responsive electronic materials exist may warrant hiring a discovery expert in the early stages of an internal investigation.[47] In addition, counsel must address the existence of the corporation's disaster recovery backup tapes early in an investigation. Backup tapes routinely are recycled from time to time by companies, with data overwritten. Once a corporation learns of circumstances that are likely to lead to a government investigation, counsel must determine whether the corporation should continue to recycle its backup tapes.[48]

The Federal Rules of Civil Procedure have recently undergone amendments, effective December 1, 2006, that place increased emphasis on the importance of gaining an early and complete understanding of client systems, data sources, and retention policies and practices in civil litigation. For example, amended Rule 26(a)(1)(B) requires that initial disclosures include a description of all electronically stored information that may be used to support the party's claims or defenses. In addition, Rule 26(f) requires the parties to confer on issues related to preserving discoverable information and develop a discovery plan that includes proposals concerning, *inter alia*, the form in which electronically stored information should be produced.[49] Rule 34 permits the party requesting documents to specifically request electronically stored information; that party may "specify the form or forms in which electronically stored information is to be produced."[50] If the requesting party does not so specify, Rule 34 requires that "a responding party must produce the information in a form or forms in which it is ordinarily maintained or in a form or forms that are reasonably usable."[51]

Recent administrative proceedings and case law illustrate the role that document retention and production can play in dealings with the government. For example, in *Halliburton*, failure to fully cooperate with the SEC's request for the production of documents resulted in financial penalties. The SEC found that, for at least five consecutive years, Halliburton failed to disclose material changes in the way it accounted for certain contracts.[52] Based on these failures, the SEC found that Halliburton violated Section 17(a)(2) of the Securities Act, Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-3 thereunder, and ordered Halliburton to cease and desist from further violations.[53] In addition, Halliburton agreed to pay a $7.5 million penalty, which was assessed, in part, due to "unacceptable lapses in the company's conduct during the course of the investigation, which had the effect of delaying the production of information and documentation necessary to the staff's expeditious completion of its investigation."[54]

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of 18 U.S.C. § 1519, which has yet to be tested in the courts, it is unclear after the Supreme Court's decision in *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005) whether one can be guilty of criminal obstruction absent a willful or corrupt state of mind. *See* Finnegan, *supra* note 11, at 3 & n.2.

[47] *See generally* Finnegan, *supra* note 11, at 4.

[48] In *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 217 (S.D.N.Y. 2003), the district court indicated that a corporation need not preserve every single e-mail and backup tape when litigation is threatened reasoning that such a requirement would "cripple large corporations." The Committee Notes to the recently amended Federal Rule of Civil Procedure 37(f), however, suggest that affirmative steps may be required to preserve backup tapes where the tapes may be the only source of certain relevant and discoverable information. In light of the harsh penalties associated with document destruction, if the internal investigation is in response to a government action, counsel's best course of action is to negotiate with the government at the beginning of the investigation, as the government's view of what must be preserved likely will vary from that of the corporation.

[49] FED. R. CIV. P. 26(f)(3). This proposed discovery plan should address topics such as the time period for which discovery will be sought, sources to be searched for discoverable information, accessible and inaccessible information, and the form in which information will be produced.

[50] FED. R. CIV. P. 34(b).

[51] FED. R. CIV. P. 34(b)(ii).

[52] *In re Halliburton Co.*, Rel. No. 34-50137, 2004 WL 1737425, at *2-*3 (Aug. 3, 2004).

[53] *Id.* at *9.

[54] *Id.* at *9 & n.11.

By contrast, in *Matter of New York Stock Exchange,*[55] the SEC credited the NYSE's voluntary and effective production of documents and information. There, the SEC alleged that the NYSE had failed to properly detect, investigate, and discipline widespread unlawful proprietary trading by specialists on the floor of the NYSE in violation of Section 19(g)(1) of the Exchange Act. The SEC accepted the NYSE's settlement offer and specifically cited the NYSE's cooperation.[56]

The *Brightpoint/AIG* SEC investigation illustrates how important it is to preserve documents when a government investigation is afoot.[57] The SEC's complaint alleged that AIG and Brightpoint violated the antifraud provisions of the Exchange Act, as well as the reporting and books and records provisions, and that AIG aided and abetted Brightpoint's antifraud violation, based on the development and marketing of a "non-traditional" insurance product for the stated purpose of enabling public reporting companies to smooth earnings by creating the appearance of insurance and an assumption of risk by AIG.[58] Brightpoint cooperated with the SEC's investigation, including the production of documents, interviews, waiver of privilege, and testimony.[59] By contrast, AIG erroneously certified that production of subpoenaed documents was complete when in fact AIG had not produced all responsive documents.[60] Because of their respective levels of cooperation, among other reasons, under their respective settlements, Brightpoint was forced to pay a $450,000 civil penalty, whereas AIG was required to pay a $10 million civil penalty and disgorge $100,000 plus prejudgment interest.[61]

Similarly, in civil litigation instituted by the government, the district court awarded sanctions against Philip Morris and its parent, Altria Group, due to spoliation of evidence in violation of a case management order that required preservation of all potentially relevant documents and other records. In *United States v. Philip Morris USA Inc.*,[62] the court noted that the defendants deleted e-mail over 60 days old on a monthly system-wide basis for two years after the entry of the case management order. After it first became aware of the problem, and the likelihood that relevant e-mails were lost or destroyed, in February 2002, Philip Morris waited an additional four months before notifying the government about the situation. It even continued its monthly deletions of e-mails in February and March of 2002. In addition, the court noted that Philip Morris identified eleven high-ranking employees who had violated the corporation's preservation procedures, including the Director of Corporate Responsibility, the Senior Principal Scientist in Research Development and Engineering, and the Senior Vice President of Corporate Affairs. Based on this conduct, the district court awarded $2.75 million in monetary sanctions, and precluded Philip Morris from calling to testify as a fact or expert witness any individual who had violated Philip Morris's document retention policies.

CONCLUSION

Today's enforcement environment is in many ways highly uncertain, and will no doubt continue to evolve. The climate of heightened cooperation has been a learning experience for corporations and regulators alike. In this environment, counsel must navigate through the various pitfalls while not violating his or her obligations to the corporation. This task will require close scrutiny of the options available to the client, and consideration of how decisions will affect (or limit) the corporation's options down the road in parallel government investigations, private litigation, or congressional hearings. ■

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[55] *In re New York Stock Exch., Inc.*, Rel. No. 34-51524, 2005 WL 840452, at *1 (Apr. 12, 2005).

[56] *Id*. at *11.

[57] *See In the Matter of American Int'l Group, Inc.*, Rel. No. 34-48477, 2003 WL 22110366 (Sept. 11, 2003); *In the Matter of Brightpoint, Inc.*, Rel. No. 34-48474, 2003 WL 22110368 (Sept. 11, 2003).

[58] *See In the Matter of American Int'l Group, Inc.*, *supra* note 57, at *12-*14; *In the Matter of Brightpoint, Inc.*, *supra* note 57, at *10-*15.

[59] *See In the Matter of Brightpoint, Inc.*, *supra* note 57, at *15.

[60] *See In the Matter of American Int'l Group, Inc.*, *supra* note 57, at *11.

[61] *See In the Matter of Brightpoint, Inc.*, *supra* note 57, at *16 & n.10 (imposing a $450,000 civil penalty on Brightpoint); *In the Matter of American Int'l Group, Inc.*, *supra* note 57, at *15-*16 & n.11 (imposing payment of disgorgement, prejudgment interest, and civil sanctions).

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[62] *United States v. Philip Morris USA Inc.*, 327 F. Supp. 2d 21, 26 (D.D.C. 2004).

The Review of Securities & Commodities Regulation