

# INTERNAL INVESTIGATIONS

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**Jim King**

614.227.2051

jking@porterwright.com

**Tom Jones**

412.235.1482

tjones@porterwright.com

**Buzz Trafford**

614.227.2149

rtrafford@porterwright.com

**David Kelch**

412.235.1497

dkelch@porterwright.com

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## Internal investigations: Their risks and benefits



We live in an era of sophisticated and pervasive scrutiny of companies (and their managers) by the government, the media, plaintiffs' lawyers and even their own employees. Companies regularly contend with whistleblower allegations, shareholder demands, external and internal audits, subpoenas, media reports, and inquiries by the government or civil litigants. An internal investigation is oftentimes the appropriate way to respond. Because corporate or executive wrongdoing may result in criminal prosecution, large civil fines or restitution, substantial damages and negative publicity, a carefully-planned and well-executed investigation is critical.

If handled properly, internal investigations can prevent additional, unforced harm to the company. For instance, one financial institution recently received a formal declination letter from the U.S. Department of Justice (DOJ) in light of the institution's post-investigation self-reporting, full cooperation and enhanced compliance program. The DOJ imposed a relatively limited amount of restitution and disgorgement on that institution. Following a similar DOJ investigation of a different bank in which, according to the DOJ, the bank did not self-report or fully cooperate with the investigation, the bank was forced to enter

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into a *deferred* prosecution agreement (leaving open the possibility of prosecution later) and pay \$101.5 million in penalties and disgorgement.

In the first segment of our *Internal Investigation Basics* series, we explore the purpose of internal investigations, the benefits of conducting one and the potential risks to the company of a poor investigation.



It is a fact-finding process that is undertaken to “get to the bottom” of potential wrongdoing.

## **What is an internal investigation?**

An internal investigation is a formal inquiry conducted by a company to determine whether laws, regulations and internal organizational policies may have been violated and, if so, recommend corrective actions. They are conducted when a company becomes aware of allegations of potential wrongdoing, whether from an outside source (e.g., law enforcement or regulatory requests for information; subpoenas, including grand jury subpoenas; media reports; reports from outside auditors, vendors, or suppliers; or civil suits) or from inside the company (e.g., compliance reports; audit reports; internal “hotlines;” or whistleblower claims).

## **Purpose and conduct of an internal investigation**

The goal of any internal investigation is to obtain an unvarnished view of the facts, that is, what happened, when did it happen, who was responsible, who may have been harmed and what further actions may be necessary to prevent the alleged wrongdoing from recurring. It is a fact-finding process that is undertaken to “get to the bottom” of potential wrongdoing by the company itself (or a related stakeholder) or by an officer, director or employee.

Because the allegations giving rise to the investigation invariably involve legal issues and potential legal claims, counsel—either in-house or outside—typically leads the investigation. In nearly all instances, selection

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of the appropriate counsel is critical. Prior experience is essential because investigations have hidden landmines that may compromise privilege, create conflicts of interest or expose those involved to possible obstruction of justice charges. In addition, with certain types of investigation, for example with special litigation committee investigations, counsel conducting the investigation must be completely independent with no prior relationship with the company or its constituents.

An internal investigation always entails data preservation, collection and review, which can be quite complex and expensive. The type of data review needed depends on the company's information technology infrastructure and the alleged wrongdoing, but usually includes electronic data (e-mail, electronically-stored memoranda, etc.), hard copy files and, sometimes, hybrid personal/work devices of company personnel (iPads, text messages and personal e-mail).

Additionally, timely interviews of relevant company personnel are critical. Witnesses can provide key background information, context to documents and other important information (which we will cover in more depth later in our series). An internal investigation—which vary greatly in scope—is appropriate any time the company is faced with an allegation of wrongdoing by its personnel, and—as is often the case—when the company is responding to a government inquiry or investigation.

Finally, a well done investigation often includes a final report (whether for just internal or both internal and external dissemination) that memorializes the investigation findings and includes conclusions for specific remedial steps to be taken by the company. Advice of counsel is needed here to preserve the company's attorney-client privilege and work product protections over the investigative findings and any related work product (final report, proffer presentation or the like).

In short, a well-done investigation assists in:

- Determining whether the factual allegations have substance
- Determining who is involved and their level of involvement
- Deciding what the proper response should be (and the legal risks associated with that response or failing to respond)
- Minimizing the company's legal exposure (whether civil, criminal or regulatory)

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- Identifying what, if any, corrective actions are needed to prevent future wrongdoing
- Potentially gaining cooperation credit from the government

## **Benefits of conducting an internal investigation**

### *Benefits to the company*

Internal investigations assist the company in gathering information, fashioning defenses and crafting a remedy for deficiencies identified. Specifically, internal investigations are useful for companies to identify personnel to censure (or worse) as well as policies or procedures that need remediation. Moreover, remedial steps may support a reduction in civil and criminal penalties levied against the company by the government or the judiciary. Additionally, an internal investigation can put a company in the position to accurately assess the alleged wrongdoing and consider initiating settlement negotiations with those harmed or, an investigation may yield support for the position that no wrongdoing has occurred.

Furthermore, an internal investigation can reflect the company's commitment to ethics and compliance, thus bolstering its reputation. Specifically, an internal investigation sends a positive message to the company's employees as well as the public. By conducting an investigation, the company demonstrates that it is taking the alleged wrongdoing seriously, and subsequent remediation demonstrates that it expects its employees to follow all laws and company policies.

Additionally, some states (e.g. Pennsylvania) confer benefits and deference to decisions by companies to pursue litigation against directors and officers where the Board empanels a special committee to investigate claims of wrongdoing. If the committee decides the derivative lawsuit is not in the best interest of the corporation, it may decline to litigate and seek dismissal of the suit. In certain jurisdictions, a well conducted investigation will support that decision and provide substantial deference to the Board's decision.

### *Benefits received from the government*

The government examines the investigation's thoroughness and findings. In making charging decisions, both the Securities and Exchange Commission and the DOJ will consider whether a corporation undertakes, and voluntarily discloses the results of, a properly conducted internal

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investigation. On May 7, 2019, the DOJ released its "[Guidelines for Taking Disclosure, Cooperation, and Remediation into Account in False Claim Act Matters](#)", explaining the criteria by which the DOJ will award cooperation credit for a False Claims Act investigation. Cooperation credit—which most frequently takes the form of a reduction in the civil damages multiplier and mitigation of criminal penalties—may be granted to companies that voluntarily disclose misconduct unknown to the government, cooperate in an ongoing government investigation and undertake appropriate remedial measures in response to a violation.

Specifically, the [DOJ Guidelines](#) provide that the government will consider the following when determining how much to credit company cooperation: "(1) the timeliness and voluntariness of the assistance; (2) the truthfulness, completeness, and reliability of any information or testimony provided; (3) the nature and extent of the assistance; and (4) the significance and usefulness of the cooperation to the government." By voluntarily conducting an internal investigation, the company can sometimes provide reason for the government to limit the scope of its investigation by showing that the company is independently gathering facts.

### **Risks of failing to investigate and of a poor investigation**

Failing to conduct an internal investigation can put the company at great risk. Failing to investigate may lead to increased scrutiny by government investigators and the judiciary and will strengthen the government's argument for imposing civil and criminal penalties. Furthermore, it sends a negative message to employees and the public, essentially signifying that the company cares little about internal compliance. Most importantly, maybe, is the civil and criminal liability that may lie against the company and its personnel if the alleged misconduct continues without remediation.

A poorly-conducted investigation brings its own set of risks. Because of this, companies should take great care in their choice of counsel. Poor choice of counsel with little investigation experience raises risks of waiver of privilege, conflicts of interest and even claims of obstructing justice. Counsel specializing in internal investigations is key. Besides having more experience in avoiding these pitfalls, experienced counsel will have more credibility, which is important if the company decides to disclose its findings.

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## Takeaways

- An internal investigation is a formal inquiry to determine whether organizational policies, laws and/or regulations have been violated.
- Internal investigations give companies the resources to identify weaknesses, discipline personnel wrongdoers and protect a company's reputation.
- The DOJ may award "cooperation credit" to companies that:
  - Voluntarily disclose misconduct;
  - Cooperate in an ongoing investigation; and
  - Undertake appropriate remedial measures in response to its findings.
- Internal investigations assist in gathering information, fashioning defenses and crafting a remedy for misconduct.

Not conducting an internal investigation will put the company at risk for increased government scrutiny and—depending upon the alleged wrongdoing—both civil and criminal liability for the company itself and the personnel involved.

*Special thanks to Kathryn Flynn for her contributions to this alert.*

For more information, please contact [Jim King](#), [Tom Jones](#), [Buzz Trafford](#), [David Kelch](#) or any member of Porter Wright's [Corporate & Internal Investigations Practice Group](#).