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The Conduct Of Independent Investigations – And The General Counsel's Role

The Editor interviews *Mary O'Connor*, Partner, Akin Gump Strauss Hauer & Feld LLP.

Editor: Please discuss your experience regarding investigations resulting from compliance failures.

O'Connor: I have conducted independent investigations for audit committees or special committees of the board of directors into a number of areas including the alleged backdating of stock option grants, alleged insider trading, and – most often – into suspected financial statement irregularities that frequently end in restatement. As hot as the stock option topic has been in the last year and a half, the issues that come out of properly accounting for and communicating the company's financial position are here to stay.

Editor: How do companies determine whether they need outside counsel to conduct an independent investigation?

O'Connor: The typical scenario arises when the company has itself identified a problem and has informed the board. Sometimes this happens on the eve of the need to issue a public filing. I am brought in when the board decides that this is really a matter of sufficient significance that it needs to be handled by an independent investigation team.

Editor: So this would not arise out of your typical representation of the client?

O'Connor: No. In fact, most of my work is directed to circumstances where the board feels that it is important to bring in someone with no prior relationship to the company who can be fully independent and assess the facts of the particular compliance failure and follow the facts as high up the chain of command as they lead.

Editor: What triggers the decision to bring in an outside investigation team?

O'Connor: Companies struggle with the decision whether to conduct an internal investigation or to go to an outside independent investigation team. They don't want to escalate an issue to the board or the audit committee until



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there is some certainty that it is significant. That mindset is something that Sarbanes-Oxley changed by requiring direct reporting to the audit committee of whistleblower claims or any issues involving potential fraud or financial statement problems. If you do retain independent counsel early, it gives you the chance to establish confidence with both the audit committee and the company's outside auditors that the matter will be vetted thoroughly so they can be in a position to rely on the findings of the investigation.

Editor: What should the objectives of an investigation be?

O'Connor: The objectives of any investigation are to find the truth and fix a problem. The way you go about that is to use appropriate procedures to find the facts, analyze whether those facts constitute a violation of company policy or applicable law, and suggest appropriate

remedial measures that will enable the company to fix the problem.

Editor: Should the investigation focus only on the facts related to the compliance failure or should it look at the larger picture?

O'Connor: An investigation should never be a rush to judgment. That is true even when time is of the essence. The company's processes for identifying and responding to compliance failures are an important part of any investigation. That aspect of the review can give you insights into how the company's compliance processes are working. In a strong compliance environment, they will tend to mitigate the fact of the failure itself. They will provide information that may suggest that a specific compliance failure is an isolated incident.

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Editor: Does there come a time when self-disclosure becomes necessary?

O'Connor: Any time that you commence an independent investigation there is a significant likelihood that at some point it may be desirable to communicate with external constituencies, whether it be to shareholders by making a public announcement about the investigation and/or to regulators by making a decision to take the facts to the SEC, DOJ or other relevant regulatory agency.

Editor: What steps need to be taken to preserve data needed in an investigation?

O'Connor: Preserving data that might be needed in an investigation is critical. This is one of the key reasons for general counsel to be brought into the loop early. A document hold allows appropriate electronic and hard copy data to be preserved. Doing that preserves data that may be needed in the investigation and protects the company against potential inferences that someone had a reason to not preserve the data for the review.

Companies should get an appropriate hold in place for electronic and hard copy data at the point where the company believes it may need to do an investigation, whether internal or external. If an outside investigation team is hired, it can always refine the scope of the hold. The fact that the company has taken appropriate steps immediately is an important demonstration of its good faith.

Editor: Why do you feel that the general counsel's role is critical?

O'Connor: The general counsel is a key gatekeeper who may also serve as trusted counselor. Where you have a potentially large issue, he or she must counsel management with respect to the company's obligations under Sarbanes-Oxley, advise them about how and when the issue should be presented to the audit committee and the board, and alert them to what the reactions of its independent directors, outside auditors, shareholders and regulators may be if management fails to take the necessary steps expeditiously.

Editor: How important is prompt disclosure to the appropriate governmental authorities?

O'Connor: Prompt self-disclosure is one of the factors listed by the SEC in the *Seaboard* report issued in 2001, which sets forth the factors that the SEC considers when evaluating a company's cooperation. The factors listed in this report serve the SEC as measures for determining the extent of any sanctions in the way that the McNulty Memo serves the DOJ. The McNulty Memo, the *Seaboard* Report, and guidelines followed by other regulatory authorities

encourage self-reporting. To the extent that you can make an early disclosure that is accurate, that is a factor that will help the company down the road in mitigating and potentially avoiding any regulatory action.

Editor: Can a sound investigation by an independent investigation team help avoid civil litigation?

O'Connor: The hard truth is that companies draw lawsuits regardless of how well they manage crisis situations. The determination to move forward with an investigation is one that companies need to make because it is a matter of good corporate governance and not because it is going to mitigate or help them avoid potential lawsuits from the private bar. As an investigator, your obligation is to conduct an appropriate investigation and make sound disclosure decisions – both public disclosures and communications with appropriate authorities so that you do not compound any issues arising out of the compliance failure you investigated. Also, a properly conducted investigation earns the confidence of regulators by demonstrating the company's intention to be transparent and to take appropriate remedial measures. Of course, a good investigator is always mindful of the possibility of attracting civil suits and does whatever is appropriate to avoid unnecessarily providing fuel for such litigation.

Editor: If an investigation is undertaken, how will that affect the privilege?

O'Connor: The attorney-client privilege and its application to investigations is a complex issue. It is not necessarily true that you will lose the privilege simply by conducting an investigation. The key question is going to be the scope of any waiver. That is an issue that counsel needs to raise early with the board or the committee that is running the investigation. You need to explain how the attorney-client privilege applies to the work being done and identify the points at which specific waiver decisions may arise.

Bear in mind the distinction between the attorney-client privilege, which in most jurisdictions will be subject to a subject matter waiver, and attorney work product, which covers the work of attorneys and those people working for them, such as forensic accountants. The work product privilege is usually limited to an item by item waiver. The specific piece of work product has to have been shown or disclosed to someone outside the scope of the privilege in order to be waived.

With that distinction between the attorney-client and work product privileges in mind, you can protect a substantial amount of the products of the investigation from discovery.

Editor: Should employees interviewed in the course of an investigation be warned about the possibility of a waiver?

O'Connor: Whether you are in-house counsel or outside counsel, you need to

give appropriate warnings to witnesses, especially employees, before you begin an interview. As a member of the bar, it is critical that you make sure that employees understand that you do not represent them as individuals and that, because the privilege applies to the communication, they cannot try to waive it. They should also understand that any decision about whether to waive the privilege will be made at a later date, and it will not be made by them.

If you tape an interview, you would have a record of the instructions to the employee. A tape or transcript of interviews would be a witness statement and would be discoverable, however, so you must weigh the benefits of maintaining the privilege against having a formal record.

Editor: There is great concern about the effect of prior DOJ policies on reimbursement of employees for their legal expenses and on the privilege. Do you see improvements as a result of the McNulty Memo?

O'Connor: The McNulty Memo is not going to be the deciding factor as to whether there will be any change in DOJ's treatment of employee indemnification or the privilege. What is going to make the difference is the continued public pressure from Congress and corporations and their lawyers to uphold the rights of individuals under company contracts to be reimbursed for their legal fees and also the concern that the Supreme Court outlined years ago in *Upjohn* that corporations have a right to the privilege.

It is in everyone's best interest that companies be encouraged to engage in self evaluation. The privilege encourages that process. The ABA is continuing to push for additional protection for companies on this front. There are ongoing efforts in Congress to make sure that companies are not being required to make wholesale waivers of privilege in order to satisfy the concerns of the DOJ or the SEC.

Editor: How does an ongoing audit committee investigation affect the management process?

O'Connor: An audit committee investigation adds an additional layer of relationships and communication needs on top of the usual management process. That additional layer, which involves the audit committee and their outside counsel and advisors, complicates decision-making for the company, ranging from issuing press releases to getting financial statements completed. Maintaining good communications between management, the committee leading the investigation, and the investigation team is critical.

Editor: What steps should in-house counsel take when the board authorizes an independent investigation?

O'Connor: Make sure that an appropriate document hold memorandum is issued and that electronic data is preserved until the investigation team is in

place. Encourage caution by the company in any public statements that are made with respect to either the investigation or the underlying compliance failure. You can compound any problems that the underlying compliance failure can create by making inappropriate or inaccurate disclosures. Think about who an appropriate point person would be within the company to work with the investigation team. Frequently it is the general counsel, but there are times when neither the general counsel nor another person in the legal department is sufficiently independent to be of assistance to the investigation team. Finally, be aware that investigations can be both time-consuming and very frustrating for management. Information is flowing to the investigation team that is not provided to management at the same time. The best role for in-house counsel to play during that process is to serve as counselor to management on the nature of the process and the need to encourage free and open cooperation with the investigation team.

Editor: Do you have a philosophy on investigation reports?

O'Connor: My philosophy on reports is that a written report is appropriate in circumstances where there are significant public constituencies that need to know all the findings of the investigation. Enron, WorldCom and a number of other situations are of so much public interest that it is really appropriate to write a full report and make it available. Because of the attorney-client privilege concerns that arise from investigations and the attendant copy-cat lawsuits that companies experience, I do not recommend written reports in garden variety independent investigations. In addition to laying out a road map for civil litigation, they also delay the finalization of the investigation. This can slow the process for finalizing the financial statements and making final reports to outside auditors and regulators so that the company can move on.

It is important that recommended remedial actions are in writing so management has a guide to what it must do to avoid future compliance failures.

Editor: Do you have any final comments?

O'Connor: Setting an appropriate scope for an investigation is the most important decision that an investigation team can make. An appropriate initial scope should enable you to conduct a more timely and efficient investigation, keeping in mind that you may find information along the way that requires expanding the scope. It is also important to set an appropriate scope because, if you are going to conduct an investigation, it needs to be done right. The biggest problem I have seen flowing from corporate investigations is the failure to follow the investigation to its logical conclusion. If you short circuit the process or overlook key issues, you can end up having follow-on investigations, having difficulty with regulators, and providing real fodder for potential civil litigation.

Please email the interviewee at moconnor@akingump.com with questions about this interview.