PORTLAND BUSINESS JOURNAL

PORTLAND, OREGON | BUSINESS NEWS FROM THE FOUR-COUNTY REGION | FEBRUARY 5, 2010

FOCUS

Internal investigations prove valuable but hold some traps

Executives involved in the incident must exercise caution

The internal investigation has long been a hallmark of the best practices of any company that is confronted with allegations of misconduct.

Unfortunately, it appears that many more businesses will face the need for internal investigations in the future. The economic meltdown, the resulting push for more regulation by Congress and the recent legislative changes to the federal whistleblower statute make it inevitable that more managers and boardrooms will receive reports of misconduct.

Thus, it is imperative that business executives understand the pluses and pitfalls of an internal investigation.

The proper internal investigation determines the validity (or non-validity) of the allegations. It identifies the wrongdoers and recommends sanctions, whether the misconduct should be disclosed to the government and ways to tighten internal controls.

The return on investment from accomplishing these goals is immense. The investigation preserves your goodwill and reputation, and should a government investigation arise at a later date, the steps taken above can be used to great advantage to argue to the prosecutors that the company should not face charges.

The first question in these situations is: When is it necessary to conduct an internal investigation? Each situation is different, but generally you need to conduct an internal investigation whenever you determine there is credible evidence of officers, employees, agents or subcontractors committing misconduct.

The general rule is to err on the side of caution. An "ostrich in the sand" approach buys temporary comfort, but later it often results in expensive employment or civil litigation or, even worse, a government investigation and perhaps prosecution involving your company.

Assuming an investigation is warranted, the second issue is: Who conducts the investigation? Inside personnel? Outside professionals? Attorney? Accountant?

Generally, if the allegations center on conduct that could result in any administrative, civil or criminal sanction by any government agency, the better practice is to engage outside professionals. When all legations are related to a breach of company policy with no foreseeable harm to customers, vendors, shareholders or the public, your human resources personnel and other management could conceivably conduct the internal investigation.

GUEST COLUMN

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If the investigation warrants outside professionals, the question is: What type of professional should be hired? Obviously, the key consideration is to hire a professional with expertise in the area that is the subject of the investigation (such as accounting fraud, environmental pollution, bribery, etc.).

However, the better practice is to hire an attorney to oversee the investigation for the following reasons.

One, most attorneys who conduct these investigations are former federal prosecutors who have spent years investigating crimes and can effectively use the internal investigation to avoid the company facing any sanctions from the government.

Two, hiring an attorney (who can then hire other professionals as needed, such as forensic accountants) will keep the work product of the investigation confidential under the lawyer's attorney-client privilege and work-product protections. This is a key point. The results of the investigation are valuable and need to be protected from unwarranted discovery by current and former employees suing the company, dissatisfied stockholders filing shareholder suits, competitors and a host of other entitles who would use the report to harm the company.

The better practice also is to engage an attorney or law firm that is nut the company's "regular" outside counsel and who will take an objective, outsider look at the problems. While the benefits to the company of well-conducted internal investigations are obvious, executives who are even remotely involved in the conduct under investigation need to proceed with caution. The first minefield concerns the scope of liability. The government not only goes after those who know of the crime or assist in the crime, but they now charge executives under a "control theory" of liability. For example, in July 2009, the Securities and Exchange Commission sanctioned two executives of a company, alleging that the managers failed to adequately supervise their "direct reports" (who either participated in or knew of the scheme to bribe foreign government officials).

The second minefield concerns the company executive's relationship with the outside attorney tasked with conducting the internal investigation. Short answer: This attorney is not your friend. This attorney is hired by the company (or the board), and that attorney's allegiance and duty to protect is owed to the person or entity who hired the attorney and not to any individual officer or employee of the company.

Therefore, if you are asked to be interviewed as part of the internal investigation, it is imperative that you retain your own attorney (often at the expense of the company or under the company's directors and officers liability insurance policy) to safeguard your own interests.

Similarly, the company's outside counsel will seek to curry favor with govern, meet prosecutors to prevent the company from being charged by "pledging" cooperation with the government. That cooperation will often include offering up those involved in the conduct underlying the internal investigation to be interviewed by government agents. Don't agree to be interviewed by the government without a lawyer by your side.

In short, an objective, well-thought-out internal investigation — while not welcome — is good medicine for the company, but employees or executives need to be on guard when they had any arguable role in the alleged misconduct.

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