# Foxes and henhouses: The importance of independent counsel

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Two significant recent events train the spotlight on corporate whistleblowers. On May 25, the Securities and Exchange Commission released its proposed final rules under the Dodd Frank Act on whistleblowers who report possible violations of securities laws. In its final rules, the Commission rejected the most important criticisms filed by public companies, including the widespread concern that the rules would gut internal compliance programs. As if on cue, on the same day, the US Department of Labor's Administrative Review Board reversed an administrative law judge's dismissal of whistleblower claims under the Sarbanes Oxley Act, and adopted liberal standards that will favor whistleblowers pursuing retaliation claims. These two events portend the road ahead for corporations confronted with whistleblowers, and highlight the need for corporations to ensure that their policies and procedures deal lawfully and effectively with whistleblower complaints.

A critical element of an effective whistleblower response is fair and objective evaluation. The need to investigate whistleblower complaints objectively dictates, in many cases, who should investigate and who should supervise the investigation. Think foxes and henhouses. It is equally important to avoid any conduct that even suggests retaliation. When investigating significant whistleblower complaints, the only reliable way to achieve objectivity and avoid the appearance of retaliation is for the company—typically a committee of the board—to retain truly independent outside counsel.

Why does the independence of counsel matter? To answer this question, you must first understand that the intended audience for the conclusions drawn from an investigation of a whistleblower complaint is often not the corporation, but outsiders—federal law enforcement agencies, judges, and potential plaintiffs in civil litigation. Although a corporation may have well-justified faith in the abilities of its regular corporate counsel (or else they wouldn't be regular counsel), it is not really the corporation's view that counts. In any investigation that matters—and this includes every investigation that asks a federal agency, judge, jury or third party to rely on its findings—the single most important factor in gaining such third-party trust will be counsel's independence. Almost by definition, at the start of any objective investigation you will not know the conclusions that will ultimately be drawn. It follows, then, that all investigations of serious whistleblower claims "matter" and should be designed for third-party consumption from the outset.

## Retaining independent counsel

At least three fundamentally significant factors should cause a corporation subject to the whistleblower provisions of Dodd-Frank to retain independent counsel for

internal investigations of most serious whistleblower complaints.

First, for a corporate ethics policy to be effective, employees must have confidence that their complaints are handled in confidence, treated seriously and objectively, and that they will not face retaliation. Even if the corporate body that supervises an investigation is considered beyond reproach, if that body hires management's lawyers, will employees have confidence that management won't be briefed or tipped and that their identity will remain confidential? And what if the whistleblower has actually worked directly with that firm and its lawyers in performing his or her duties? While the law firm might have the best intentions in terms of maintaining confidentiality, the appearances may be more important than their actions. Whistleblowers who conclude that their complaints are not fairly and objectively investigated are more likely to report to law enforcement agencies like the Securities and Exchange Commission (SEC). And if litigation erupts, these appearances can constitute evidence that could lead courts or juries to draw various negative inferences, regardless of the underlying truth of the matter.

To appreciate how pervasive this problem can be, consider that at the start of almost every interview with company employees, the investigating lawyer will begin by giving an Upjohn warning (also known as a corporate Miranda speech), advising that the employee is not the firm's client, that the corporation is the client, and that the corporation may decide to divulge the information communicated by the employee if it is in the corporation's best interests. This awkward beginning may cause employees to be confused or uncertain about confidentiality, and justifiably suspicious that their statements could be relayed to management, to their detriment. Some employees will equate this corporate Miranda to legal cautions with which they are far more familiar: "What you say can and will be used against you." The self-preservation instincts aroused by the corporate Miranda instruction are real, and regaining trust that management's lawyers will respect their confidentiality after hearing this instruction is a challenge. Appropriate reassurances of confidentiality from independent counsel are likely to be better received than those from interviewers perceived as "management's lawyers."

Second, if regular outside counsel conduct an investigation that comes to touch on their own prior advice or legal work, a plethora of loyalty and privilege problems can arise. The first problem is that the lawyers' powerful instincts for self-preservation (i.e., avoiding malpractice claims) may result in prejudice to the client, if the client does not receive from corporate counsel complete information about corporate counsels' prior advice.

Unrelated to this problem but equally significant, if there is a later decision to waive the attorney-client privilege in the investigation, a "subject matter" waiver could jeopardize other communications with the same law firm that are on the same subject matter but did not occur in the investigation. For example, if SEC disclosure counsel advised management or the directors about executive compensation matters, retaining the same firm to investigate allegations of improprieties because they "have a leg up" substantially increases the risks for waiver of the privilege on all of the firm's prior advice about compensation. Ring-fencing earlier corporate advice from later investigatory advice is more difficult when the same firm is involved in both phases, and lines become blurred. The law firm and the client might not even recognize that there is a relationship between the earlier advice and the later investigation at the time the investigation starts. Corporate decisions about whether and how to waive privileges in communications with law enforcement agencies are fraught with complexity and grave risks, but this scenario—facing the risk of a broad waiver of privilege over sensitive communications with the firm's outside counsel—may actually prevent the client from having

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a meaningful choice whether to waive the privilege as to information that it might otherwise wish to disclose to government lawyers.

On top of these problems, the risk that other privileged communications related to the same subject matter will only be discovered or recognized after the investigation is well under way may result in a forced withdrawal of legal counsel that (1) consumes large amounts of board time and attention; (2) leaves the client with the unwelcome prospect of paying a new firm to re-start the investigation from scratch; and (3) jeopardizes relations with or commitments to the SEC, the Department of Justice (DOJ), or other law enforcement agencies about the time line to complete and report on the investigation. Worse still, the involvement of regular corporate counsel might taint the entire investigation in the eyes of lawyers for the government, with potentially irremediable consequences for future enforcement actions, whistleblower claims, or shareholder lawsuits.

The third major issue involves relations with law enforcement. In a high percentage of situations, it is necessary or desirable to report to law enforcement agencies on the results of the investigation. This is a critical task, and if the report of investigation is relatively favorable to the company and management, one of the questions any government lawyer will need to ask is whether the internal investigation was a "whitewash." One common prejudice often voiced by lawyers in federal enforcement is that any investigation conducted by regular corporate counsel cannot be objective and cannot be relied on for law enforcement decisions. When an agency such as the SEC or DOJ cannot rely on the company's own internal investigation, it necessarily either conducts its own, or expands the scope of its own investigation. This can be bad enough, but the agency may also proceed with an unnecessarily jaundiced view of the corporation, and perhaps with suspicions of a "cover up." Were the files cleaned up? Were witnesses influenced? Were the facts massaged and stories coordinated? Having the agencies preoccupied with these kinds of questions is not helpful to a quick, fair, and optimum resolution, especially if the agency must also consider potential obstruction of justice issues. Getting off on the wrong foot with enforcement authorities may make all the difference, and obviously, any justification of saving legal expenses by using existing counsel already familiar with the company would be criticized heavily in hindsight should these circumstances come to pass.

## The appearance of bias

In-house corporate lawyers may be unfamiliar with these complications, and need to turn to outside counsel for guidance. Will your regular corporate outside counsel give you this same advice? Excellent lawyers fully devoted to the best interests of their clients will obviously do so when appropriate. In some situations, however, current counsel may hesitate. Partners in law firms have strong incentives to increase their billing credits and may find ways to rationalize to themselves and their clients why their firm should handle an investigation, notwithstanding these complications, especially if outside corporate counsel are unfamiliar with these land mines, which is true of many corporate lawyers who are not white collar litigators. And in an increasingly competitive global legal market, some regular outside counsel can also behave like jealous spouses, living in fear that if they introduce their best clients to another law firm they might lose their client.

Corporations should take these biases and shortcomings into consideration in evaluating any advice from outside counsel offering their own firm's services for internal investigations. They should seek input and guidance from other counsel experienced in internal investigations, which is readily available. Corporations faced with investigations of whistleblower complaints might also consider the famous words of Donald Rumsfeld that in addition to "known unknowns," there are also "unknown unknowns."

At the outset of a fast-moving internal investigation, it may not be possible to know all of the contingencies, conflicts, and relationships that will come within the scope of the investigation, and it is hubris to think otherwise.

The best approach is almost always a cautious prophylactic approach—to choose a strategy that minimizes the potential for these conflicts to occur. In most circumstances, this will require retention of independent outside counsel to assist in responding to whistleblower complaints. In short, to be independent, a law firm should not provide regular advice or services to the corporation, and its lawyers should not have personal relationships with officers or directors that might give even the appearance of bias. Again, objectivity is the goal, and even a slight appearance of bias or favoritism can be more damning than the reality.

## Disadvantages

Are there disadvantages to retaining independent counsel? There can be. One disadvantage is that independent counsel may lack familiarity with the company, and may need to incur additional expense to get up to speed. Although familiarity may be helpful, this problem is less than meets the eye. Gaining adequate familiarity with the area to be investigated is usually a manageable task, and in order to be truly objective, the investigation must be conducted without preconceived ideas or blinders. Additionally, investigating counsel may interview and obtain the fruits of the corporate counsels' existing knowledge. It is also possible to design internal investigations that are either scalable or phased, and thus expand or contract in size and scope as circumstances and developing information dictate.

A second perceived disadvantage may be that management is less comfortable with investigating lawyers with whom they are not familiar. Here again, query whether having management who are comfortable with lawyers they know well—and to whom the lawyers are beholden—is even a desirable objective. Think foxes and henhouses, accented with divided lawyer loyalties.

Whistleblower complaints are dangerous. Once the tag "whistleblower" attaches to an employee, even a misinformed or misguided employee, the consequences of mishandling the complaint can range from serious to catastrophic. Whether a complaint is handled properly or improperly is in large measure in the eyes of the whistleblower, and counsels' conduct of any investigation is crucial. When a mishandled complaint turns into a whistleblower lawsuit, they can be extraordinarily difficult to defend. It is very hard to attack the whistleblower's claims without appearing to attack the whistleblower, especially when the whistleblower is opportunistic. Judges and juries are highly protective of all employees who wear the mantle of the whistleblower, not to mention Congress and federal whistleblower laws. Think David and Goliath, but David has an army of lawyers orchestrating a media circus, and David has a mutual defense treaty with the law enforcement agencies of the United States of America.

## Truly independent counsel

The cost of defending government enforcement actions, whistleblower claims, and shareholder lawsuits can exceed the expense of an objective investigation by orders of magnitudes. The trouble is, a corporation may be unable to predict in advance which whistleblower complaints pose serious threats to the corporation, and the consequences of guessing wrong may lead to disaster. The only recognized tonic is to address all complaints objectively, and where a complaint is determined to involve serious allegations, to ensure the objectivity of the investigation by retaining truly independent counsel who does not have disabling relationships with management.

There may be situations where retaining regular corporate counsel's firm would be appropriate to review a whistleblower claim, but they would be the exception rather than the rule, and may often be

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limited to an initial review to determine whether a more intensive investigation is warranted. Generally, caution is the better part of valor, and independence of counsel can vaccinate a company against many of the unforeseen ills that befall investigations of whistleblower complaints. ✳

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# Compliance & Ethics PROFESSIONAL

Vol. 8 / No. 4
08 / 2011


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