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THE VALUE OF ENGAGING OUTSIDE COUNSEL IN INTERNAL CORPORATE INVESTIGATIONS

Independent outside counsel play a critical role in assisting audit committees in internal investigations, while reinforcing their core missions of independence and oversight. In this article, we provide practical guidance on the value of engaging outside counsel in corporate investigations, including the legal requirements applicable to audit and special committees, the important roles that outside counsel play in internal investigations, and the serious risks that companies may face by conducting internal investigations without the use of independent outside counsel.

By Rizwan A. Qureshi and Jay K. Simmons *

Dating back to the 1940s, in order to encourage accurate financial disclosures, the Securities and Exchange Commission ("SEC") has encouraged publicly traded companies to adopt policies and procedures for the use of independent audit committees.[1] Today, acknowledging that managers may face market pressures exacerbated by compensation incentives focused on short-term stock appreciation — and the resulting potential for managers' personal interests to diverge from the long-term best interests of the company's shareholders — the SEC enforces substantive rules requiring the use of independent audit committees. In 2003, the SEC issued Final Rules to implement Section 301 of the Sarbanes-Oxley Act of 2002.[2] Under these

[1] *See, e.g.*, *In re McKesson & Robbins*, Accounting Series Release (ASR) No. 19, Exchange Act Release No. 707 (Dec. 5, 1940).

[2] Final Rule on Standards Relating to Listed Company Audit Committees, 68 Fed. Reg. 18788, 18788 (Apr. 25, 2003) [hereinafter "Final Rule"] (adopting new Rule 10A-3 and amending Forms 20-F and 40-F, Items 7 and 22 of Schedule 14A under the Exchange Act of 1934, amending Item 401 of Regulation S-B and Item 401 of Regulation S-K under the Securities Act of 1933, and amending Form N-CSR under the Exchange Act and the Investment Company Act of 1940). *See generally* 17 C.F.R. §§ 430.10A-3 [hereinafter "Exchange Act

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rules, an audit committee must typically be comprised solely of "independent" directors and must maintain direct responsibility for the appointment, compensation, and oversight of the company's independent directors.[3]

In the wake of the 2008 financial crisis and the enactment of sweeping financial regulatory reform legislation, the Department of Justice ("DOJ"), SEC, and other law enforcement and regulatory bodies have increased enforcement of white-collar crimes.[4] In this new era of white-collar enforcement, upholding the core responsibilities of audit committees — *independence* and *oversight* — are mission critical. Nowhere is that more apparent than in circumstances in which a company must consider how to investigate potential misconduct by its employees or officers.

Indeed, the SEC has long taken the view that "misdeeds by corporate executives and independent auditors have damaged investor confidence in the financial markets," and these concerns underscore "the need for *strong, competent and vigilant audit committees*" that have "*real authority*" to audit matters in keeping with the long-term best interests of the company's shareholders.[5] Yet, in the context of internal investigations, the finer points of precisely *how* to maintain independence and oversight are all too often misunderstood or simply overlooked. This, in turn, can entail serious legal consequences for an unwary company — particularly if such conduct ever subsequently becomes the subject of a government investigation.[6]

This article reviews the legal requirements companies should consider with respect to audit and special committees.[7] Next, it explains the substantial value presented to companies by engaging independent outside counsel to lead internal investigations, providing a practical roadmap that companies can use to evaluate whether engaging outside counsel will effectively promote an audit committee's dual missions of oversight and independence. The article concludes by highlighting a common pitfall that companies face in the course of internal investigations undertaken by independent audit and special committees: the potential waiver of privilege protections in connection with any company documents and communications sought in subsequent government investigations.

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Rule 10A-3"], 249.220f, 249.240f, 240.14a-101, 228.401, 249.331, 274.128.

[3] Final Rule, 68 Fed. Reg. 18788, 18790–91.

[4] *See, e.g.*, SEC Press Release No. 2024-186, *SEC Announces Enforcement Results for Fiscal Year 2024* (Nov. 22, 2024), https://www.sec.gov/newsroom/press-releases/2024-186. In 2024, the SEC filed 583 total enforcement actions while obtaining orders for $8.2 billion in financial remedies — the highest amount in the Commission's history. DOJ similarly reported an uptick in FCPA-related actions in 2024, and in August 2024, the Department launched its Corporate Whistleblower Awards Pilot Program. DOJ, *Related Enforcement Actions: 2024* (updated Jan. 13, 2025), https://www.justice.gov/criminal/related-enforcement-actions-2024; DOJ, *Criminal Division Pilot Program on Voluntary Self-Disclosures for Individuals* (Apr. 15, 2024), https://www.justice.gov/media/1347991/dl?inline.

[5] Final Rule, 68 Fed. Reg. 18788, 18789 (emphasis added).

[6] B. Bondi & M. Wheatley, *The Complete Compliance and Ethics Manual 2023, Independent Investigations Overseen by the Audit Committee: Procedures and Guidance* at 1 (SCCE 2023) (noting that in this new era of white-collar enforcement, a company's "failure to be proactive in the face of allegations of corporate misconduct can be financially devastating to a company and may expose management and directors — even independent directors — to personal liability").

[7] Separate from independent audit committees, companies may establish "special committees" of the board of directors, which are essentially *ad hoc* committees comprised solely of independent members, as in the case of potential conflict of interest transactions. *See, e.g.*, *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997) (involving special committee established in connection with sale of partial interest in corporation by individual shareholder to second corporation controlled by same shareholder). *See generally* Gregory V. Varallo, *et al.*, *From Kahn to Carlton: Recent Developments in Special Committee Practice*, 53 BUS. LAW. 397 (1998). The legal considerations for both audit and special committees are highly analogous, and for this reason, the article uniformly refers to "audit committees" unless otherwise required for context.

I. LEGAL REQUIREMENTS FOR AUDIT COMMITTEES

As prefaced, rules promulgated by the SEC mandate that publicly traded companies install independent directors to their boards. At a high level, a company is obligated to disclose (1) the names of the directors that the board has determined are "independent" under the rules of the relevant securities exchange on which its shares are traded, (2) a description of any additional standards for independent directors, if the company maintains additional standards as a matter of policy, and (3) a description of the transactions, relationships, and other arrangements that the board considered in rendering its assessment of each director's independence.[8] In line with the view that 'sunshine is the best disinfectant,' the mandated disclosures under Item 407(a) of SEC Regulation S-K require companies to provide detailed information to the market, which helps to reinforce independence and oversight in the management of the company's affairs.

The SEC's Final Rule and associated amendments to the Code of Federal Regulations lay out two ways that a director may be prohibited from sitting on an independent audit committee, based on prohibited *compensation* or a prohibited *affiliation*. As the regulation puts it, an audit committee member may not (1) accept, directly or indirectly, "any consulting, advisory, or other compensatory fee" from the company or any of its subsidiaries *or* (2) be affiliated with the management of the company or any of its subsidiaries.[9] Prohibited compensation includes both direct payments and indirect payments to officers, such as reimbursement for services to external vendors — including law firms or other external entities in which members may hold ownership or managerial interests — and even payments to members' "spouses, minor children, or stepchildren, or children or stepchildren sharing a home with the member."[10] However, this provision does not disqualify audit committee members based on payment of regular dividends to the member in his or her capacity as a shareholder of the company or based on fees paid for the member's capacity on the audit committee or any other committee of the board of directors.[11]

The rule extends to any "affiliated person," which encompasses anybody who, other than in his or her capacity as a member of the audit committee, board of directors, or other board committee of a listed company or any of its affiliates, "directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with," the company.[12] "Control," in turn, is defined broadly to entail "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."[13] Importantly, a "safe harbor" applies to exclude from the regulatory definitions any member who is not an executive officer or a shareholder owning 10% or more of any class of voting equity securities.[14]

The New York Stock Exchange ("NYSE") and Nasdaq, Inc. ("Nasdaq") separately require that a majority of directors of a listed company's board of directors must be independent. The listing organizations have their own definitions of "independence," although they largely mirror those in the SEC's Final Rule. Certain additional requirements imposed by the NYSE[15] provide that an audit committee member is *not independent* if:

- the member is an employee or immediate family member who is or was an executive officer of the company in the *prior three years* (the "look-back period");
- the member or an immediate family member received more than $120,000 in direct compensation from the company in any 12-month period during the look-back period, excluding director fees, committee fees, pension, and other forms of deferred compensation for prior service where compensation does not hinge on continued service; or
- the member or an immediate family member is a current partner of the company's internal or independent auditor, a current employee of such a

[8] Item 407(a), Regulation S-K. Note also that all director independence information must also be disclosed in the company's Form 10-K and proxy statement.

[9] Final Rule, 68 Fed. Reg. 18788, 18791–95; *see also* Exchange Act Rule 10A–3(e)(1)(i); Exchange Act Rule 10A–3(e)(4).

[10] Final Rule, 68 Fed. Reg. 18788, 18791–92.

[11] *Id.* at 18791 n.45.

[12] *Id.* at 18793; Exchange Act Rule 10A–3(e)(1)(i).

[13] Final Rule, 68 Fed. Reg. 18788, 18793; Exchange Act Rule 10A–3(e)(4).

[14] Final Rule, 68 Fed. Reg. 18788, 18793; Exchange Act Rule 10A–3(e)(1).

[15] NYSE, NYSE-2009-89, "Section 303A.02 Independence Tests" (Nov. 25, 2009).

company, personally works on the company's audit, or was, but is no longer, a partner or employee of such a firm and personally worked on the company's audit in the previous three years.

Nasdaq imposes the same three-year look-back period and imposes similar additional requirements to NYSE.[16]

There are a few notable exceptions to these general guidelines to maintain "independence" of audit committee members:

- Where a member serves on *both* the audit committee of a company and its affiliate, to the extent that the member otherwise satisfies the independence requirements for each entity, and only if the member does not receive compensation beyond that permitted for service as a member of each respective board of directors, audit committee, or other committee of the board of directors.[17]

- If a company seeks to go public, it must have only one fully independent member at the time of initial listing, a majority of independent directors within 90 days of the listing, and a wholly independent committee by one year after the listing.[18]

Beyond codifying the standard for "independence" of audit committee members, the SEC's Final Rule further requires companies to promote effective means to share information about the company's reporting policies and procedures. In short: "[e]ach audit committee must establish procedures for the receipt and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees . . . of concerns regarding questionable accounting or auditing matters."[19] Given that management may not have sufficient incentives to "self-report all questionable practices," these rules require "establishment of formal procedures" that encourage proper individual conduct and "alert the audit committee to potential problems before they have serious consequences."[20] There are no hard-and-fast guidelines on what set of policies and procedures are sufficient under the regulation. Rather, the SEC notes that "audit committees should be provided with *flexibility* to develop and utilize procedures appropriate for *their circumstances*," while ensuring that the relevant policies and procedures meet the minimum requirements outlined above.[21]

Finally, it is important to keep in mind that the SEC requires companies to give audit committees the authority to engage outside advisors, including outside counsel, "as [the audit committee] determines necessary to carry out its duties."[22] However, this rule does *not* preclude an audit committee from seeking or obtaining advice from the company's *internal* counsel — nor does it *require* an audit committee to retain "independent counsel."[23] In keeping with these requirements, the SEC obligates publicly traded companies to provide appropriate funding and resources, as determined by the audit committee, for payment to (1) any registered public accounting firm engaged for the purpose of preparing an audit report and related audit work and (2) any advisors employed by the audit committee.[24]

II. ENGAGING OUTSIDE COUNSEL IN THE COURSE OF INTERNAL INVESTIGATIONS UNDERTAKEN BY AUDIT COMMITTEES

In light of the foregoing requirements, companies alerted to potential malfeasance on part of their employees or officers face a dilemma. The standing audit committee (or a special committee, as appropriate under the factual circumstances and applicable company policies), must maintain the independence of the members of the committee while ensuring that the results of the investigation are timely and effectively shared with management to resolve any ongoing concerns. It can become quite challenging to insulate an internal investigation from improper influence while making sure that the company's managers are properly positioned to make important business decisions. Information adduced in the course of an internal investigation may, of course, implicate important strategic decisions; but there are also important legal implications that arise from management's direct involvement.

[16] Nasdaq, SR-NASDAQ-2023-005, "Corporate Governance Requirements" (Oct. 2, 2023).

[17] Final Rule, 68 Fed. Reg. 18788, 18794–95 ("Overlapping Boards").

[18] *Id.* at 18794 ("New Issuers").

[19] *Id.* at 18790.

[20] *Id.* at 18798 ("Procedures for Handling Complaints").

[21] *Id.* (finding that a "'one-size-fits-all' approach would be inappropriate") (emphasis added).

[22] Final Rule, 68 Fed. Reg. 18788, 18798.

[23] *Id.* at 18798 n.114.

[24] *Id.* at 18798–99 ("Funding").

To address this dilemma, a company generally has two choices: (1) conduct an internal investigation overseen by the management team and led by the in-house or outside corporate counsel or (2) conduct an *independent*, internal investigation overseen by the audit committee or a special committee of the board of directors (composed entirely of independent directors), using outside counsel with no prior (or at least, no conflicting) representation of the company.[25] A middle path — hiring the company's regular outside counsel to conduct the investigation — may also be a possibility, depending on the nature of the conduct and the outside firm's past work for the company.

Taking a step back, companies may rightly wonder when an audit committee investigation is even required. Typically, this is addressed in the company's policies; but to the extent not specifically addressed, common situations that trigger the need for an internal investigation conducted by such committees involve management uncovering evidence of:

- occupational misconduct on part of an employee or officer (*e.g.*, fraud, theft, embezzlement, corruption);
- transactions that raise potential conflicts of interest;
- improper accounting practices;
- irregularities in employee compensation;
- irregularities in stock option grants or other securities transactions;
- improper payments to public officials; and
- improper communications with competitors (*e.g.*, sharing commercially sensitive non-public information).[26]

In short, the audit committee should consider whether, especially in these situations, it is necessary to engage outside counsel. Counsel can help by (1) providing advice on how to conduct the investigation and (2) conducting aspects of the investigation that the audit committee delegates to counsel, which are reported on only to the extent and in the manner necessary to maximally preserve privilege protections.[27] The audit committee ultimately directs the investigation, maintaining oversight of the process, while the role of outside counsel is to ensure the company's best interests are protected — both in the course of investigating the conduct and well down the line, when government investigators may come knocking.[28]

Although it may be possible for the in-house team to conduct an effective investigation under the supervision of management, oftentimes, the nature of the misconduct at issue makes it challenging — if not impossible — to avoid the potential for conflicts of interest to emerge between managing directors' short-term financial interests and the long-term best interests of the company's shareholders. These risks may magnify considerably if the conduct at issue is particularly salacious or implicates management in wrongdoing. The alternative course, engaging outside counsel, is specifically contemplated by the SEC's Final Rule. And, as explained below, it is often a reasonable, cost-effective mechanism to ensure that the investigation is in all facets undertaken independently and without a bias in favor of current management to provide adequate oversight of the shareholders' interests.

From a practical standpoint, any investigation can involve significant cost, time, and distraction from business operations; and any conduct that warrants investigation requires a thorough review to ensure that the company's interests are effectively safeguarded.[29] Pursuing an independent investigation with the engagement of independent outside counsel offers many benefits that outweigh related costs — often in ways that can only be fully appreciated *long after the investigation has concluded*, in connection with the government's investigation of the underlying conduct. Here we provide some practical guidance on the substantial benefits provided by engaging outside counsel, and how this strategy unlocks client value by: (1) ensuring maximal protections of legal privilege for communications and documents created in the course of the investigation; (2) promoting the credibility of the company's response in the eyes of regulators; and (3) enabling companies to unlock benefits of leniency, including cooperation credit, and the resulting mitigation

[25] B. Bondi & M. Wheatley, *supra* note 6, at 1.

[26] *See generally* Ernst & Young & Squire Sanders (US) LLP, *The audit committee's evolving role in overseeing corporate investigations* at 4 (2013).

[27] G. Markel, *et al.*, *Internal Investigations Special Committees Resource* (July 6, 2017), *available at* https://corpgov.law.harvard.edu/2017/07/06/internal-investigations-special-committees-resource/.

[28] *Id.*

[29] *Id.* at 2.

of criminal and civil penalties in the event of a subsequent government investigation.

A. Protecting Legal Privilege

Initially, engaging independent outside counsel to conduct an investigation rather than conducting the investigation through the in-house team promotes important legal privilege protections afforded under the attorney-client privilege and attorney work-product doctrines.[30] The first step in securing privilege is identifying the attorney-client relationship that exists between the outside counsel and *the company* (and, more specifically, *the independent audit committee*), for purposes of providing legal advice to the company's board of directors. The relationship does not extend to the company's personnel — individuals who, based on the nature of the underlying conduct, may well have divergent interests from the company in (1) identifying and (2) remediating any misconduct. In other words, the privilege belongs to the *client* — the company, not its employees — and only the company may choose to waive the privilege in ways inconsistent with the interests of certain personnel. Outside counsel can easily caution employees with an *Upjohn* warning: making clear in the course of any interviews that counsel represents the company, not the employee, and that the company may waive the privilege if it wishes.

Although it is possible to preserve these privileges through the use of in-house counsel, as a practical matter, the use of company legal counsel may not adequately promote the independence of the investigation. Moreover, in-house counsel may themselves have been involved in or aware of information relevant to the underlying investigation, creating potential conflicts that undermine the privilege protections afforded to attorney-client communications. The context of board committee investigations adds complexity to the situation because while communications between outside counsel and a committee of the board of directors are protected by the privilege, communications between outside counsel for the committee and other company counsel or management is often more opaque.[31] Independent outside counsel thus serve as a bulwark between potential conflicts of interest that may arise as an investigation reveals, for example, that in-house lawyers or other outside counsel for the company were involved in the conduct. Rather than reporting to the committee with supervision from the in-house team or other company counsel, an independent outside firm can make practical recommendations to transfer oversight of the investigation directly to a special committee of the board of directors.

Outside counsel also promote protection of privileged information by directly communicating with third-parties, like forensic accountants and investigative firms, which often play key roles in internal investigations.[32] The same is true for any external auditors engaged by the committee,[33] as well as non-attorney support, like paralegals and data processing firms, who may be

[30] *See generally Upjohn Co. v. U.S.*, 449 U.S. 383, 389 (1981) (the purpose of the privilege "is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice"). These privileges extend to communications of legal advice between clients, counsel, and certain of their agents (for example, independent investigators engaged by outside counsel) — but, importantly, they *do not* protect underlying facts (*i.e.*, the factual findings and conclusions rendered by outside counsel in the course of providing legal advice to the company). *Upjohn Co.*, 449 U.S. at 395–96 ("The protection of the privilege extends only to *communications* and not to facts. A fact is one thing and a communication concerning a fact is an entirely different thing." (emphasis added)).

[31] *E.g.*, *Ryan v. Gifford*, Civil Action No. 2213-CC, 2007 WL 4259557, at *3 n.2 (Del. Ch. Nov. 30, 2007).

[32] *E.g.*, *Clark v. City of Munster*, 115 F.R.D. 609, 613 (N.D. Ind. 1987) ("Statements made by [the client] to a private investigator employed by his attorney are protected by the attorney-client privilege."). Outside counsel are involved in the process at each stage to ensure that third-party investigators do not inadvertently create communications outside the scope of the privilege. *E.g.*, *Claude P. Bamberger Int'l, Inc. v. Rohm and Haas Co.*, Civ. No. 96-1041 (D.N.J. Aug. 12, 1997) (memorandum summarizing communications between investigator and client's employees was not privileged because it was not made for the purpose of securing legal advice).

[33] In general, disclosing otherwise privileged information to independent auditors engaged by the committee will result in subject-matter waiver of attorney-client privilege. *E.g.*, *United States v. Deloitte LLP*, 610 F.3d 129, 139–40 (D.C. Cir. 2010) (voluntary disclosure to auditors waives attorney-client privilege, but it does not necessarily waive work-product protection); *SEC v. Microtune, Inc.*, 258 F.R.D. 310, 317 (N.D. Tex. 2009) (disclosure to outside auditors waives attorney-client privilege); *SEC v. Brady*, 238 F.R.D. 429, 439–40 (N.D. Tex. 2006) (noting that "disclosure of privileged information directly to a client's independent auditor . . . destroys confidentiality" resulted in waiver of privilege). *See generally Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992).

involved in interfacing with personnel at the company.[34] In short, engaging outside counsel ensures that the whole team is properly walled off and information is not shared outside of the attorney-client relationship.

Outside counsel can also serve as a direct liaison between counsel engaged for other parties relevant to an internal investigation (for example, counsel for the company's vendors, distributors, or customers), further protecting the privilege by avoiding the need for management or in-house attorneys to communicate directly with other parties' counsel. Additionally, because the underlying purpose of privileged communications must be the provision of legal advice to the client, independent outside counsel can more effectively — both in appearance and in fact — ensure that the communications are subject to protection at all phases of factual investigation.[35]

This is of particular import in the process of creating any work product summaries containing factual findings from the investigation. Outside counsel may prepare these materials and base ultimate findings provided to the audit committee upon these materials. While providing the audit committee with ultimate factual findings (which would not be subject to privilege in any case),[36] with respect to any other information adduced in the course of the investigation, outside counsel can ensure that work product contains attorney mental impressions and conclusions presumptively subject to protection. Similar protections may exist in the context of certain investigations undertaken by in-house teams — but the risks, particularly in high-profile investigations, may be greater than the costs of engaging outside counsel.[37]

Another important consideration with respect to privilege is maintaining *confidentiality* of communications between the client and counsel.[38] Because the presence of third parties to attorney-client communications undercuts the finding that the client reasonably possessed an expectation of confidentiality with respect to the communication, involving certain personnel in the course of communicating legal advice may destroy the privilege. The overlapping roles of in-house counsel (*i.e.*, proverbially wearing 'two hats' between counseling on the business's day-to-day affairs *and* the ongoing internal investigation) can make it much harder to ensure that all relevant communications remain confidential between the client (*i.e.*, the company or committee) and independent counsel conducting the investigation.

Finally, it is important to remember that cross-border investigations often raise additional complexities that are more efficiently managed by outside counsel, rather than in-house teams. For example, European law has long held that in-house counsel are not able to exercise independence from the companies they serve, and thus

[34] *E.g.*, *United States v Kovel*, 296 F.2d 918, 926 (2d Cir. 1961) ("The complexities of modern existence prevent attorneys from effectively handling clients' affairs without the help of others; few lawyers could now practice without the assistance of secretaries, file clerks, telephone operators, messengers, clerks not yet admitted to the bar, and aides of other sorts. The assistance of these agents being indispensable to [the lawyer's work] and the communications of the client being often necessarily committed to them by the attorney or by the client himself, the privilege must include all the persons who act as the attorney's agents.").

[35] *E.g.*, *United States v. ISS Marine Servs., Inc.*, 905 F. Supp. 2d 121 (D.D.C. 2012) (where communications arose in context of internal investigation undertaken by audit personnel and not outside counsel, communications were not covered by the attorney-client privilege or attorney work-product doctrine). Engaging outside counsel to conduct each phase of an investigation also promotes privilege protection by making clear that the communications are undertaken for the purpose of the outside counsel providing advice to the company vis-à-vis its independent audit committee, rather than for a more general purpose, like concerns about legal compliance. *United States ex rel. Barko v. Halliburton Co.*, No. 1:05-CV-1276, Slip Op. at 5 (D.D.C. Mar. 6, 2014) (communications in investigations were not privileged where they were "undertaken pursuant to regulatory law and corporate policy rather than for the purpose of obtaining legal advice").

[36] *Upjohn Co.*, 449 U.S. at 395-96 ("The protection of the privilege extends only to *communications* and not to facts. A fact is one thing and a communication concerning a fact is an entirely different thing." (emphasis added)).

[37] *Infra* Section III.

[38] *See generally* Rest. 3d Law Gov. Lawyers § 71 ("A communication is in confidence . . . if, at the time and in the circumstances of the communication, the communicating person reasonably believes that no one will learn the contents of the communication except a privileged person . . . or another person with whom communications are protected under a similar privilege."), *id.* § 71(c) ("The circumstances may indicate that the communicating person knows that a non-privileged person will learn of it, thus impairing its confidentiality. For example, a client may talk with a lawyer in a loud voice in a public place where non-privileged persons could readily overhear.").

their communications with the company may not be subject to privilege protection.[39]

B. Promoting Credibility of Response

Beyond the strategic benefits from a privilege standpoint, engaging independent outside counsel to conduct investigations on behalf of companies' audit or special committees has the practical advantage of adding credibility to the company's response to suspected wrongdoing. Rather than managing the problem in-house, engaging outside counsel promotes the appearance and reality that the investigation is conducted in a manner that minimizes improper influence or conflicts from self-interested management. Running an investigation with independent counsel confers credibility and can be a valuable bargaining chip with government investigators. Indeed, the SEC and DOJ require companies to provide audit committees adequate resources to engage external assistance from counsel and promote the use of independent internal investigations undertaken by such committees.[40] Engaging independent outside counsel also gives a company more options in terms of remediating the underlying conduct, by helping to maintain independence in the removal of culpable employees and improvement of internal controls and policies.[41]

C. Reducing the Likelihood of Severe Government Penalties

A third main benefit to engaging independent outside counsel is that doing so may result in leniency or reduced penalties in connection with any government investigation of the underlying conduct. Initially, Chapter 8 of the Federal Sentencing Guidelines provides: "The two factors that mitigate the ultimate punishment of an organization are: (1) the existence of an effective compliance and ethics program and (2) self-reporting, cooperation, or acceptance of responsibility."[42] Sentencing reductions are available under Chapter 8 where a company demonstrates that "prior to an imminent threat of disclosure or government investigation" and "within a reasonably prompt time after becoming aware of the offense," the company "reported the offense to appropriate governmental authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct."[43]

Companies should also consider leniency considerations provided under the SEC's rules. In 2001, the SEC released the *Seaboard Report,* which provides guidance on how the Commission evaluates a company's eligibility for reduced charges or sanctions based on "self-policing, self-reporting, remediation, and cooperation."[44] The SEC also highlights its Enforcement Cooperation Program and expects companies to promptly report misconduct when it is identified.[45]

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[39] *E.g.*, Case C-550/07P, *Akzo Nobel Chems. Ltd. & Ackros Chems. Ltd. v. Comm'n*, 2010 E.C.R. I-08301.

[40] B. Bondi & M. Wheatley, *supra* note 6, at 2.

[41] *Id.*

[42] U.S. Sentencing Commission, U.S. Sentencing Guidelines Chapter 8 Introductory Comment [hereinafter "U.S.S.G."]*; id.* § 8B2.1 Application Note 6 ("[T]he organization should respond appropriately to the criminal conduct. The organization should take reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct. These steps may include, where appropriate,

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providing restitution to identifiable victims, as well as other forms of remediation. Other reasonable steps to respond appropriately to the criminal conduct may include self-reporting and cooperation with authorities.").

[43] U.S.S.G. § 8C2.5(g)(1) ("Self-Reporting, Cooperation, and Acceptance of Responsibility"); *id.* §§ 8C2.5(g)(2) (providing a two-point reduction in base culpability score where the company fully cooperated in the investigation but did so after the imminent threat of disclosure or government investigation), 8C2.5(g)(3) (providing one point reduction in base culpability score where the company "clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct").

[44] *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*, Exchange Act Release No. 44969, (Oct. 23, 2001), https://www.sec.gov/litigation/investreport/34-44969.htm [hereinafter "*Seaboard Report*"].

[45] SEC, Division of Enforcement, *Benefits of Cooperation with the Division of Enforcement* (updated Oct. 11, 2024), https://www.sec.gov/enforcement/enforcement-cooperation-program ("The SEC's Cooperation Program has proven valuable in a wide range of cases spanning the full spectrum of its enforcement program from insider trading and market manipulation to FCPA violations and financial fraud."); Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source

The *Seaboard Report* includes specific questions that, along with other factors, drive the SEC's analysis of a company's cooperation for leniency purposes:

- How did the company cooperate with SEC staff's investigation?
- What compliance procedures were in place to prevent the misconduct now uncovered?
- How was the misconduct detected and who uncovered it? Did the company report the conduct to the SEC, or did the SEC know about the problem before hearing from the company?
- What steps did the company take upon learning of the misconduct?
- What assurances are there that the conduct is unlikely to recur?[46]

Based on findings that companies satisfied the requirements of self-policing, self-reporting, remediation, and cooperation, in light of its consideration of these specific questions, Commission staff "routinely impose[] reduced penalties and sanctions" on companies otherwise subject to liability under federal law.[47] In several recent cases cited by the SEC, the agency has opted not to impose penalties after obtaining consent agreements resolving the charges, highlighting instances in which companies promptly undertook an internal investigation and voluntarily disclosed key factual findings to investigators.[48]

The SEC's *Enforcement Manual* formalizes this policy by making clear that a company's voluntary disclosure of information "need not include a waiver of privilege to be an effective form of cooperation and a party's decision to assert a legitimate claim of privilege will not negatively impact their claim to credit for cooperation."[49] Notably, though, the decision whether to share privileged materials with the Commission has serious legal consequences — which may be more efficiently navigated with the assistance of experienced outside counsel. For example, disclosure of privileged communications and attorney work product to the SEC generally includes a waiver as to other third parties, such as civil litigants or the DOJ.[50] Companies can optimize the benefits of leniency and privilege protection by providing information to investigators orally, limiting the discussion to only non-privileged factual information obtained from the investigation. As discussed in the following Section III, even where a company engages outside counsel, this process can be fraught with pitfalls, and companies often are much better positioned to avoid these pitfalls with the assistance of experienced outside counsel.

A recent example of the benefits of cooperating with federal law enforcement agencies arose in 2020, when the SEC and DOJ entered agreements with a South Carolina-based consumer loan company to resolve a longstanding investigation into alleged violations of the Foreign Corrupt Practices Act ("FCPA").[51] Despite finding that employees of the company's Mexican subsidiary had bribed government officials to the tune of $4,000,000 between 2010 and 2017, DOJ declined to prosecute World Acceptance Corporation, citing its

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[46] *Seaboard Report*.

[47] SEC, Division of Enforcement, *Benefits of Cooperation with the Division of Enforcement* (updated Oct. 11, 2024), https://www.sec.gov/enforcement/enforcement-cooperation-program.

[48] *E.g.*, *In re GTT Commc'ns, Inc.*, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, File No. 3-21708 (SEC Sept. 25, 2023), *available at* https://www.sec.gov/litigation/admin/2023/33-11241.pdf.

[49] SEC, Office of Chief Counsel, Division of Enforcement, *Enforcement Manual* at 76 (Nov. 28, 2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[50] *See generally In re Pac. Pictures Corp.*, 679 F.3d 1121, 1129 (9th Cir. 2012); *In re Qwest Commc'ns Int'l, Inc.*, 450 F.3d 1179, 1197 (10th Cir. 2006); *Burden-Meeks v. Welch*, 319 F.3d 897, 899 (7th Cir. 2003); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 295 (6th Cir. 2002); *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 686 (1st Cir. 1997); *Genentech, Inc. v. United States Int'l Trade Comm'n*, 122 F.3d 1409, 1416–18 (Fed. Cir. 1997); *Westinghouse Elec. Corp.*, 951 F.2d at 1425; *In re Martin Marietta Corp.*, 856 F.2d 619, 623–24 (4th Cir. 1988); *Permian Corp. v. United States*, 665 F.2d 1214, 1221 (D.C. Cir. 1981).

[51] SEC Press Release No. 2020-177, *SEC Charges Consumer Loan Company with FCPA Violations* (last updated Aug. 6, 2020), https://www.sec.gov/newsroom/press-releases/2020-177; DOJ, World Acceptance Corporation Declination Letter (Aug. 5, 2020), https://www.justice.gov/criminal/criminal-fraud/file/1301826/dl?inline.

prompt, voluntary self-disclosure of the misconduct and proactive cooperation in the government's investigation.[52] After the bribery scheme was uncovered in 2017, the company immediately undertook corrective actions, including terminating key officers with oversight over the Mexican subsidiary and conducting an independent audit.[53] The fact that prosecutors declined to bring charges in this case, in light of the company's swift remedial measures and use of internal audit committee procedures to address its apparent compliance failures, is significant given the serious and longstanding nature of the conduct at issue.

III. THE PITFALLS OF PROCEEDING WITHOUT OUTSIDE COUNSEL

Even when companies engage independent outside counsel to conduct an internal investigation under the direction of an audit or special committee, there are strategic risks that can arise. Arguably, the most important concern is how to navigate the fine line between timely providing information necessary for the audit committee to provide the board of directors with guidance on how to proceed while protecting the privilege. Similar issues arise in the context of towing the line between fully cooperating with government investigators and preserving privilege protections of any communications and documents created in the course of an internal investigation. In both cases, the key is for outside counsel to reinforce walls that maintain the confidentiality of information uncovered in the investigation. This can be accomplished in a variety of ways, including by:

- generating work product summaries of interviews and counsel's review of company documents;
- adopting "do-not-forward" policies or otherwise imposing restrictions on access to other electronically stored information transmitted to the audit committee or in-house teams; and
- relying on "clean teams" within the in-house legal department (*i.e.*, walling off individuals within the company's legal department from counseling on the company's day-to-day affairs, reducing the likelihood of inadvertently piercing the privilege).

These measures, while not exhaustive, are often helpful for outside counsel to directly interface with the audit committee and in-house teams as needed, while avoiding significant risks of piercing the privilege in subsequent government investigations or civil disputes.

As a general rule of thumb, if possible, it is preferable not to provide work-product summaries (including copies of any written report prepared by outside counsel for purposes of advising the audit committee) directly to (1) the company's managing directors (who may be conflicted) or (2) government regulators (unless compelled to do so by order of court, after asserting privilege and work-product protections). Doing so risks a finding that the company waived the privilege, exposing the entire report to civil litigants or the government in later discovery.[54]

In a similar vein, when faced with the challenge of fully cooperating with government investigators while attempting to maximize privilege protections for information adduced in an internal investigation, a common strategy is for counsel to provide regulators with oral presentations of non-privileged facts obtained from investigation interviews and counsel's review of company documents. This is also a common process for interfacing between outside counsel and any of the company's managing directors. However, counsel must be careful not to 'spill the beans' and expose the company to inadvertent waiver of the privilege, such as by taking down verbatim notes of witness interviews or 'purely factual' summaries, rather than preparing written reports to contain protectable attorney impressions and legal analysis of the underlying facts. A number of

[52] DOJ, World Acceptance Corporation Declination Letter at 1 (Aug. 5, 2020), https://www.justice.gov/criminal/criminal-fraud/file/1301826/dl?inline; *In re World Acceptance Corp.*, SEC File No. 3-199905 (Aug. 6, 2020), https://www.sec.gov/files/litigation/admin/2020/34-89489.pdf.

[53] K. Johnston, *Prompt Self-Reporting & Full Compliance in Foreign Corrupt Practices Act Case Persuade SEC and DOJ to Exercise Leniency* (Sept. 16, 2020), https://www.johnstonclem.com/news-insights/prompt-self-reporting-full-cooperation-in-foreign-corrupt-practices-act-case-persuade-sec-and-doj-to-exercise-leniency/.

[54] *E.g.*, *In re Leslie Fay Cos. Sec. Litig.*, 161 F.R.D. 274, 283–84 (S.D.N.Y. 1995) (observing that audit committee's production of audit report to SEC "waived any work-product immunity and attorney-client and self-critical analysis privileges covering the report itself," and further holding that "equitable piercing of the attorney-client privilege" also extended to all underlying documents referenced in the report, unless outside counsel could demonstrate "on a document by document basis" that the individual documents "contain legal advice or advice not contained or discussed in the [audit report]").

courts have expressed skepticism about mincing between counsel's physical production of interview notes and memoranda and oral proffers of factual contents in such documents.[55] In short, this distinction is far clearer — and the privilege protection far less uncertain — where (1) outside counsel properly document attorney impressions and legal analyses in reports generated in the course of the investigation, (2) counsel share this information with management and regulators only on a 'need-to-know' basis with an instruction to maintain strict confidentiality, and (3) and counsel share only *non-privileged* information (*i.e.*, discrete factual findings), rather than attorney impressions and the conclusions derived therefrom.

IV. CONCLUSION

In the modern era of white-collar enforcement, engaging and properly utilizing independent outside counsel helps to protect a company's long-term best interests and promote audit committees' twin missions of independence and oversight. Companies should be prepared to handle sensitive internal investigations — and particularly those involving potential conflicts of interest with managing directors and in-house teams — in tandem with outside counsel. These practical guidelines offer a roadmap to effectively utilizing outside counsel when the need arises. ■

[55] *SEC v. Herrera*, No. 17-cv-20301, 2017 WL 6041750 at *5 (S.D. Fla. Dec. 5, 2017) (noting that the court was "not convinced" that "there is a meaningful distinction between the actual production of a witness interview note or memo and providing the same or similar information orally"); *SEC v. Vitesse Semiconductor Corp*., No. 10 CIV. 9239 JSR, 2011 WL 2899082, at *3 (S.D.N.Y. July 14, 2011) ("While it is undisputed that NuHo did not actually produce the notes themselves to the SEC, after reviewing the SEC's notes the Court found that NuHo effectively produced these notes to the SEC through its oral summaries."); *SEC. v. Berry*, No. C07-04431 RMW HRL, 2011 WL 825742, at *5–6 (N.D. Cal. Mar. 7, 2011) (finding waiver of privilege in interview memoranda for five witnesses where attorneys orally disclosed to the SEC facts contained in the interviews).

The Review of Securities & Commodities Regulation