

## Corporate Governance Issues in Antitrust Internal Investigations

By Larry Gaydos and Brian McKay

When Congress passed the Sarbanes-Oxley Act of 2002 (“SOX”), it was called “the most far-reaching reforms of American business practice since the time of Franklin Delano Roosevelt.”<sup>1</sup> Everyone expected that corporate governance would be revolutionized, but the ultimate impact on collateral legal practice areas was less certain. After more than five years of post-SOX experience, the impact of that corporate governance legislation on other areas of practice can be more meaningfully assessed. Where attorneys conducting antitrust internal investigations traditionally focused on fact gathering and antitrust legal advice, they must now assist publicly traded clients in navigating the increasingly complex body of corporate securities law.

The purpose of this article is to highlight some of the more important corporate governance issues that may impact antitrust internal investigations with specific emphasis on: (a) determining who should conduct an internal investigation, (b) structuring the investigation to protect the attorney-client privilege, (c) developing an awareness of disclosure obligations under securities laws, and (d) sensitizing clients and investigating attorneys to the collateral criminal offenses that may become relevant during the course of internal investigations. Although these issues can properly be viewed as germane to investigations involving a wide range of substantive law, special attention is provided to their applicability to antitrust matters.

Antitrust internal investigations are more complicated than many security fraud internal investigations because misconduct like price-fixing is typically an on-going activity, increasingly involves multi-national cartels, by definition involves third party competitors, and the antitrust amnesty program provides very significant incentives to the first competitor to self-report. At the same time, investigating counsel can’t lose sight of the fact that antitrust violations also typically involve other “frauds” by senior management, weaknesses in internal controls, management integrity issues, deviations from corporate codes of ethics, violations of securities trading organization rules and regulations, and potentially material changes to past or future financial reporting . . . all issues with corporate governance or disclosure implications.

### I. Choosing the Internal Investigation Team

Once corporate management determines that an internal investigation must be initiated, the first decision that must be made is a significant one: who will conduct the investigation? This question is often focused on the selection of outside counsel, but consideration should also be given to the establishment of a proper internal protocol for overseeing the investigation and acting on behalf of the company.

Unnecessary delay in laying the foundation for an investigation can have significant consequences to the company. In many circumstances, the internal investigation team must work quickly to uncover facts and documents ahead of a parallel government investigation. In the antitrust investigation, however, the pace can be even more rapid, as there are often competitors who are forming

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<sup>1</sup> White House Press Release, *President Bush Signs Corporate Corruption Bill* (July 30, 2002), available at <http://www.whitehouse.gov/news/releases/2002/07/20020730.html> (“[T]oday I sign the most far-reaching reforms of American business practice since the time of Franklin Delano Roosevelt. . . . This law says to every dishonest corporate leader: you will be exposed and punished. . . . This law says to corporate accountants: the high standards of your profession will be enforced without exception; the auditors will be audited; the accountants will be held to account. . . . This law gives my administration new tools for enforcement. We will use them to the fullest.”).

investigation teams of their own and working to be the first in the door of the Department of Justice Antitrust Division to obtain a marker for amnesty. The company that moves too slowly out of the starters' blocks risks falling behind parallel investigations among competitors and places itself at a disadvantage for obtaining amnesty.

Since the implementation of SOX, there has been a trend toward using independent outside counsel to conduct internal investigations. This trend has been fueled in large part by a perception that the SEC and DOJ place greater weight in the findings and conclusions of law firms that have few ties to the companies they investigate. In the recent wave of stock option backdating cases, the vast majority of public companies used independent outside counsel supervised by a committee of independent directors. The same was obviously true in the civil derivative litigation that paralleled or followed those investigations. Although SOX did not directly mandate that audit committees conduct certain investigations using independent outside counsel, it encouraged that process by specifically providing that "each Audit Committee shall have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties,"<sup>2</sup> one of which is to process complaints regarding "accounting, internal accounting controls, or auditing matters."<sup>3</sup> In the antitrust context, however, the Antitrust Division has not expressed concern over the use of company counsel to conduct an investigation, and it is likely more important that counsel selected for the investigation is knowledgeable in the subject area and respected for its ability to conduct effective investigations. Investigations that begin as antitrust matters can sometimes implicate other areas of law and, even when confined to antitrust issues, may require interfacing with agencies other than the Antitrust Division. For this reason, a company may decide to select independent counsel to conduct the investigation, even when it thinks at the outset that the investigation will be confined to antitrust issues.

Once the company resolves to hire independent counsel, the next question that naturally arises is how the company will determine whether outside counsel is independent. The government agencies that prefer to deal with independent counsel have yet to specify the attributes of an investigation team that is considered "independent." When considering independence, the SEC examines whether the company has previously engaged the law firm.<sup>4</sup> There should be little doubt that a law firm that has not done any work for the company, and does not have a current commitment for significant future work, would be considered independent. Such a stringent standard should not be the test of independence, however, as it could significantly limit the field of qualified investigation counsel for many large companies that are served by many different major law firms. Additionally, hiring counsel who has no previous experience with the company could result in financial and time inefficiencies as counsel work to learn the business and the operations relevant to the investigation.

Conversely, counsel that were involved directly in matters subject to investigation or receive substantial fees from the entity being investigated will likely not be viewed as independent.

Selecting outside counsel is just the first step in assembling the internal investigation team. The company must ensure that the company's internal oversight of the investigation is structured to effectively

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<sup>2</sup> § 301(m)(5).

<sup>3</sup> § 301(m)(4)(A).

<sup>4</sup> When outside counsel is hired to conduct an investigation, the tenth factor listed as guiding the Commission's discretion whether to bring enforcement proceedings against a company includes consideration whether management had previously engaged counsel to do other work. Securities and Exchange Commission, Exchange Act Rel. No. 44969, 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 (Oct. 21, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm> ("Seaboard Report").

supervise the investigation and is empowered to move quickly on behalf of the company in response to information developed in the investigation. When the investigation could implicate members of senior management, the current trend is to structure the investigation to be supervised by the company's audit committee or a special committee comprised of independent directors. Investigations that do not pose a significant likelihood of involving senior management may be supervised by the company, often through its senior manager or legal department.

When an Audit Committee, or special committee of the board, conducts the internal investigation, it is important that the corporate documents creating the committee, e.g., the Audit Committee Charter, Board Resolution, etc., authorize the committee to take the appropriate actions that might be necessary. Typical authorizations include retention of consultants, waiver of work product or privilege, and cooperation with government entities. Corporate governance documents, such as the Bylaws or an Audit Committee Charter, may define the committee's authority too narrowly or impose limitations on the authority of certain officers or board committees. Counsel conducting an internal investigation should consult these governance documents at the outset to ensure that the committee doesn't unknowingly commit an *ultra vires* act, such as disclosing confidential company information to third parties without authority. When there is ambiguity concerning the committee's authority, counsel may be wise to obtain a resolution of the full Board expressly delegating authority to the board committee.

## II. Controlling the Attorney-Client Privilege

Every antitrust internal investigation should start with the presumption that attorney-client privilege will be preserved at some level. The first step is to identify what specific privileges may be applicable. If the investigation is conducted by independent directors using outside independent counsel, the privilege applicable to those communications can, and should, almost always be protected. Regardless who conducts the investigation, there will usually be privileged communications between the company's regular outside counsel and senior management about the investigation. Those privileged communications can, and should, almost always be protected.

Communications between in-house counsel and senior management are often more difficult to sort out. At one end of the spectrum, legal advice to senior management about the investigation and the antitrust implications of the investigation normally would be protected in the United States. Because in-house counsel are involved in a broad array of discussions, meetings, and counseling with management about many topics, it may be difficult to parse out "business advice" from protected "legal advice." It is also more difficult to protect against inadvertent waiver if that advice is co-mingled through multiple forms of written and electronic communications, e.g., email, handwritten meeting notes, multi-subject staff briefings, etc.

Even if a company expects that it will ultimately waive attorney-client privilege, it should structure the investigation to ensure that any waiver is made at a time and on terms within the company's control. If the company decides to waive the privilege, it should do so only when waiver secures a real and tangible benefit and does not unduly prejudice the company in parallel or future civil proceedings.

The first step in structuring the investigation to maximize the protection of privileges is to clearly separate attorney work-product from attorney-client privileged communications. If the company cooperates with the government to gain leniency or amnesty, it will certainly be necessary for the company to waive attorney work-product protection. Work-product can be selectively waived.

It is axiomatic that the attorney-client privilege only protects communications incident to the provision of legal advice. Communications that reflect an attorney's business advice are generally not afforded protection by the privilege. This distinction is important in the internal investigation setting, and many courts have evaluated whether internal investigations were initiated to provide legal advice or to simply obtain factual information for use in business decision making.

Courts have often determined that the privilege does not attach to attorneys' actions when they merely serve as factual investigators. For example, in *Lewis v. United States*,<sup>5</sup> the court held that an attorney's investigation of an alleged tax deficiency was not privileged when the attorney's review consisted of interviewing witnesses, acting as the secretary at corporate meetings, and researching potential solutions to the company's issues. The court determined that the attorney's "actions resembled those of a business advisor and not of a legal counselor."<sup>6</sup>

Contrary to *Lewis*, many courts have held that a company's engagement of legal counsel to conduct an internal investigation is prima facie evidence that the retention was made for the purpose of obtaining legal advice.<sup>7</sup> The Eighth Circuit, sitting en banc in *Diversified Industries v. Meredith*, concluded that hiring a law firm to conduct an investigation creates a presumption that the investigation is covered by the privilege, unless a clear showing is made that the retention was not made to obtain the provision of legal services.<sup>8</sup> When an investigation contains fact gathering, legal advice, and business considerations, the privilege will often attach.<sup>9</sup> But counsel should not assume that favorable presumptions will always be applied. Engagement letters and documents that outline to the scope of the investigation should expressly contemplate the legal services that will be provided.

The task of ensuring that the attorney-client privilege covers investigation materials and discussions takes on an added dimension when the investigation involves the collection of information outside the United States. Counsel must understand how each jurisdiction implicated by the investigation treats attorney-client communications. This was reinforced by the recent *Akzo Nobel*<sup>10</sup> decision from the European Court of First Instance, which held that under European Union law, the company can have privileged conversations only with attorneys who are licensed to practice law under the European Community ("EC") regime. Although the decision has been appealed, the current state of EC law as expressed in *Akzo Nobel* is that in-house counsel communications with company personnel are not considered privileged. Neither are communications between United States counsel and management in Europe. Therefore, when structuring an investigation that will involve Europe, the investigation team should consider incorporating participation by counsel licensed to practice in the EC in any witness interviews or correspondence.

The full effects of the *Akzo Nobel* decision on trans-Atlantic investigations have yet to be realized. At a minimum, investigation counsel should incorporate EC-licensed counsel to assist with interviews and other investigatory steps taken in Europe. Additionally, European in-house counsel should continue to treat communications with company personnel as privileged, notwithstanding that it may be ultimately subject to a successful challenge under *Akzo Nobel*. Because the *Akzo Nobel* decision is on appeal, a company that concedes communications with internal counsel are not privileged—and treats materials accordingly as non-confidential—may not be able to take advantage of a future decision that

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<sup>5</sup> No. 02-2958 B/An, 2004 U.S. Dist. LEXIS 26680 (W.D. Tenn. Dec. 7, 2004).

<sup>6</sup> *Id.* at \*9.

<sup>7</sup> *See, e.g., Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 610 (8th Cir. 1977) (en banc).

<sup>8</sup> *Id.*

<sup>9</sup> *See, e.g., SEC v. Brady*, 238 F.R.D. 429, 439 (N.D. Tex. 2006). *But see In re Syncor ERISA Litig.*, 229 F.R.D. 636, 645 (C.D. Cal. 2005) (holding that internal investigation materials were never privileged because the documents "were created with the intent to disclose them to the Government, if necessary, to benefit [the company] in any governmental investigation").

<sup>10</sup> Joined cases T-125/03 and T-253/03, *Akzo Nobel Chemicals Ltd. and Akros Chemicals Ltd. v. Commission*, judgment of Sept. 17, 2007.

recognizes the privilege. Moreover, failure to treat the communications as confidential could risk waiving the privilege in a United States proceeding.

Investigation counsel and their clients should vigilantly monitor transnational information-sharing agreements between the United States and European governments and protest the use of *Akzo Nobel* to bypass domestic privilege rules. One potential result of *Akzo Nobel* is that the United States government may increasingly seek company documents turned over to European authorities, including documents that would be privileged under U.S. law, on the likely basis that any privilege over the documents was waived by their disclosure to European authorities. When considering whether a “waiver” of privilege has occurred, American courts have recognized a distinction between “voluntary disclosure” to the government and “compelled disclosure” to the government.<sup>11</sup> If the record demonstrates the European authorities compelled the company to produce documents that it otherwise treated as confidential, the production may not operate as a waiver under domestic rules of privilege.

Generally, any waiver of attorney-client privilege carries the risk that some jurisdiction may find that the company has waived all privilege with regard to the “subject matter” of the waived communication.<sup>12</sup> Unfortunately, the law with regard to waiver of attorney-client privilege is neither clear nor uniform. Counsel cannot determine with certainty the breadth of any waiver that might result from a disclosure of privileged communications. If the disclosure of privileged information about the internal investigation into the public domain waives the privilege, courts have broad discretion in interpreting the “subject matter” of the waiver.

A limited disclosure of information to third parties, under compulsion of law or pursuant to a confidentiality agreement, may or may not operate as a broad subject matter waiver over all the investigation materials. Some courts have held that limited disclosures made to the government under an agreement that they will remain confidential does not operate as a waiver of the privilege as against all third parties.<sup>13</sup> Others, however, conclude that disclosure of privileged information to anyone outside the “magic circle” of people necessary for the provision of legal services to the company waives the attorney-client privilege more broadly as to all third parties.<sup>14</sup> Until the Supreme Court or Congress provides additional guidance regarding the selective waiver issue, counsel should proceed with caution and ensure clients understand the risks of disclosure.

When senior management or directors are potentially implicated in the investigation, presenting the investigation team’s observations and conclusions to them may waive the privilege over the investigation. In *Ryan v. Gifford*,<sup>15</sup> the Delaware Court of Chancery recently held that waiver of the privilege occurred when the investigation report was presented to the full board, which included directors who were subjects of the investigation and their individual attorneys. The court held that these individual board members and their attorneys did not share a common interest with the special litigation committee

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<sup>11</sup> See *Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1427 & n.15 (3d Cir. 1991) (noting that, if company had sought to quash grand jury subpoena and produced document only on a court order to do so, the appellate court would not have considered disclosure to the government to be voluntary).

<sup>12</sup> See, e.g., *Brady*, 238 F.R.D. at 441; *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 230 F.R.D. 433, 436 (D. Md. 2005).

<sup>13</sup> See, e.g., *In re Natural Gas Commodities Litig.*, 232 F.R.D. 208, 211 (S.D.N.Y. 2005).

<sup>14</sup> See, e.g., *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 684-86 (3d Cir. 1997).

<sup>15</sup> Civil Action No. 2213-CC, 2007 WL 4259557 (Del. Ch. Nov. 30, 2007), *interlocutory appeal denied*, 2008 WL 43699 (Del. Ch. Jan. 2, 2008).

that commissioned the investigation.<sup>16</sup> The court premised its waiver holding on the facts that the presentation of the investigation was made to the directors in their individual capacity rather than their fiduciary capacity, their individual attorneys were present, and the individual directors used privilege information in a subsequent lawsuit to exculpate themselves. Although the chancellor later issued a separate opinion clarifying that it would not have found waiver if these three facts had not be present,<sup>17</sup> the case illustrates that careful consideration must be given to any presentation of the investigation results, even when disclosed to people inside the company who were once considered safe to receive privileged communications.

### III. Disclosure Obligations and Considerations

A public company's ability to maintain confidentiality over an antitrust internal investigation may be impacted by various corporate governance rules and regulations. Although disclosures of antitrust misconduct to the Antitrust Division, or other antitrust enforcement agencies, made to obtain leniency or amnesty may be kept confidential, if the antitrust internal investigation uncovers evidence of fraud, deficiencies in internal controls, breaches of its code of ethics, or violations that materially impact past or future financial reporting, various disclosures outside the company may be required. The discussion below highlights several commonly implicated corporate disclosure obligations that might be implicated in an investigation of a typical antitrust price-fixing cartel.

#### A. SOX Officer Certifications.

At least every quarter (as part of the Form 10Q and Form 10K filings), the CEO and CFO must sign a certification that,

- (a) All significant deficiencies and materials weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting . . . has been disclosed to both the audit committee of the board and to the outside auditors.

Part (b) of § 302(a)(5) is particularly problematic in the context of an antitrust internal investigation because of its obvious ambiguity and the absence of any additional interpretive guidance. "Fraud" is not further defined, nor is the level of certainty that triggers this disclosure obligation addressed in either the statute or the legislative history. It is important to note that the fraud does not have to be material. Furthermore, "management" is not further defined. Is anyone with the title of "manager" necessarily included? If the company requires certain subordinates to sign their own sub-certifications as part of this certification process, are those employees covered?

The vagueness of this disclosure obligation can put the CEO and CFO in a difficult position in the early stages of an investigation when evidence is only partially developed, but a quarterly public filing is due. Their dilemma is aggravated by the fact that the criminal provisions of SOX make false certifications a potential felony offense.<sup>18</sup>

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<sup>16</sup> *Id.* at \*3 & n.8.

<sup>17</sup> *Ryan*, 2008 WL 43699, at \*5.

<sup>18</sup> 18 U.S.C. § 1350.

**B. Outside Auditor Disclosure Responsibility.**

Once a potential management fraud comes to the attention of the outside auditor of a public company during the course of their audit activities, it has parallel obligations under Section 10A of the Securities Exchange Act of 1934 to investigate corporate misconduct. When the auditor “becomes aware of information indicating that an illegal act . . . has or may have occurred,” the auditor must determine whether it is likely that the illegal act occurred and then assess whether the act had a material effect on the company’s financial statements. Materiality for these purposes can include both a quantitative and a qualitative component. Senior management misconduct that calls into question the integrity of personnel integral to the financial reporting process may be material qualitatively even if it is not material quantitatively.

If the misconduct is deemed material, the outside auditor is charged with assessing management’s remedial response. If management fails to take appropriate remedial action, the outside auditor must notify the Audit Committee or the Board. If management still doesn’t take timely and appropriate action, the auditor must issue a Rule 10A Report. The Board must then notify the SEC within one business day. The auditor must notify the SEC if the Board does not.

Relationships between investigating counsel and outside auditors need to be structured in a way that both parties can ultimately discharge their investigative responsibilities. The timing of information sharing pursuant to proper client authorization is a key component of the investigation. Partial disclosures to auditors can be problematic and investigation counsel should be cognizant of the SOX criminal provisions making it a federal offense to mislead auditors.<sup>19</sup>

**C. Attorney Disclosures.**

Most counsel are familiar with SOX’s controversial attorney “up-the-ladder” internal disclosure provisions that were implemented in Section 307 of the statute and the “noisy withdrawal” proposed legislation which was not passed after much opposition and debate.

Less publicity and attention has been given to a potentially troubling “permissive disclosure” provision contained in Section 205.3(d)(2). This rule permits counsel to disclose confidential client information to the SEC to the extent the attorney reasonably believes necessary to prevent certain material violations that are “likely to cause substantial injury to the financial interest or property of the issuer or investors.”

Some commentators have said this provision is consistent with existing state ethics rules; some have suggested this provision may actually pre-empt contradictory state ethics rules. The courts generally have not directly addressed the applicability of their state rules to counsel making permissive disclosures under this SOX provision. Neither has the government addressed whether the SOX provision could be read as a mandatory disclosure provision in some states where the state ethics rules would require, or permit, disclosure. Counsel faced with this issue should carefully consider the applicability of the state ethics rules of the jurisdictions where they are licensed as well as the jurisdiction where they are practicing.

**D. Disclosures under Regulation S-K.**

Three sections of Regulation S-K may impact the disclosure of facts uncovered in internal investigations. First, Item 103 requires the issuer to describe any material pending legal proceedings, including “any such proceedings known to be contemplated by governmental authorities.” It is unclear in many situations at what point the government is contemplating legal proceedings. When the internal

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<sup>19</sup> SOX § 303(a).

investigation is initiated in response to a government subpoena, or the company is pursuing leniency, is it reasonable to infer that the government is contemplating legal proceedings? Second, Item 401(f)(2) requires a description of events “material to an evaluation of the ability of or integrity of any director, person nominated to become a director or executive officer” who is named as a subject of a pending criminal proceeding. Third, Item 303 requires that the company discuss as part of its management discussion and analysis any “known trends or uncertainties” that have or are reasonably expected to have a material impact on net sales or revenues. Such discussion may be required, for example, if an internal investigation revealed that a market allocation scheme had been employed and that, as a result, revenues were materially misstated. Discussion of these results may be required, because the scheme may have had a material effect on past revenues, or remedial measures may reasonably be expected to impact future revenues in the regions subject to the allocation scheme. Additionally, if restitution is required, such restorative measures may impact the company’s net revenues.

#### **E. Disclosures on Form 8-K.**

Two aspects of Form 8-K may become relevant during an internal investigation into anticompetitive conduct. When results of an investigation lead the company to conclude that prior financial statements should not be relied on because of an error in the statements, Item 4.02 requires that the company disclose, among other things, a brief description of the facts underlying the conclusion. Item 5.05 may also become relevant when certain designated officers are implicated in conduct that does not comport with the company’s code of ethics. This item requires disclosure of any waiver of a provision of the code of ethics, which includes any implicit waiver that results when the company “fail[s] to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer . . . .”

#### **IV. Collateral Offenses**

The Sarbanes-Oxley legislation also increased sensitivity to collateral criminal offenses that may be implicated during the course of an internal corporate investigation. The provisions that most frequently become germane to an investigation are provisions prohibiting retaliation against whistleblowers, witness tampering, and obstruction of justice.

Whistleblower protection is enforced through both civil causes of action and criminal sanctions.<sup>20</sup> SOX modified 18 U.S.C. § 1513 to include “interference with lawful employment or livelihood” among the prohibited retaliatory conduct against a witness who provides truthful information to a law enforcement officer concerning a potential violation of federal law. Violation of this statute is punishable by ten years in prison and a substantial fine.

The federal witness tampering statute was not implemented as part of SOX, but the legislation has heightened awareness to its relevance in the corporate fraud context. Section 1512 of Title 18 United States Code criminalizes the use of intimidation, threats, or misleading conduct to influence testimony in an official proceeding or to cause the destruction of evidence.

The federal statute precluding obstruction of justice (18 U.S.C. § 1512) has been subject to broader interpretation in the past few years since SOX was enacted. In recent years the DOJ has attempted to stretch the obstruction statute to prosecute witnesses who lie to private attorneys conducting internal investigations, when the witness is aware that the information they provide may be turned over to federal investigators.<sup>21</sup> This enforcement change has not been fully tested in the courts, and it is unclear whether such conduct may constitute obstruction as a matter of law.

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<sup>20</sup> 18 U.S.C. §§ 1513, 1514A.

<sup>21</sup> See, e.g., Indictment at Count Ten, *United States v. Singleton*, No. H-06-080 (S.D. Tex. Mar. 8, 2006).



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