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WHITE-COLLAR CRIME

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Beyond 'Upjohn': Necessary Warnings in Internal Investigations

Corporate internal investigations have become a potent tool for prosecutors in gathering evidence against corporate employees suspected of wrongdoing.

These employees, including officers and directors, have financial incentives to be cooperative with the internal investigators as noncooperation will often result in their termination. Because of their vulnerability and the fact that the fruits of the investigation are now frequently delivered to the interested prosecutor, the methods and warnings used by the internal investigators have become increasingly important.

Internal investigators often present themselves as the representatives of benevolent corporations looking out for the best interests of all and not as an arm of the prosecution, hell bent to waive the corporation's attorney-client privilege, which is often closer to reality. Warnings then are the last remaining mechanism to ensure that some degree of fairness is injected into the process.

The phrasing of warnings that investigating attorneys give to witnesses they are interviewing has long been informed by the Supreme Court's 1981 opinion in *Upjohn v. United States*,[1] which set forth the requirements that must be satisfied in order to protect communications with corporate employees under the attorney-client privilege. An "*Upjohn* warning"

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is one in which, at a minimum, a corporate employee is advised that the interviewing attorney represents the company rather than the employee. More recently, these warnings have also come to be referred to as "Adnarim warnings," based on a backward spelling of "Miranda."[2] This minimal type of warning may no longer be sufficient in light of several recent cases.

If Internal Investigations Deemed 'Flawed'

If the internal investigation process is deemed by any of the parties to be flawed, litigation will probably ensue. Almost a decade ago, in *United States v. Weissman*,[3] U.S. District Court for the Southern District Judge Charles S. Haight Jr. refused to dismiss an indictment for perjury and obstruction of justice against the former chief financial officer of Empire Blue Cross and Blue Shield, which at the time was being investigated by the United States Attorney's Office for the Southern District of New York. An attorney for Empire had handed over to prosecutors a memorandum generated by his colleague that described the colleague's interview of the former CFO, despite the fact that the interview had taken place pursuant to a joint defense agreement. The Empire attorney did not receive permission from the CFO to turn over the memorandum. The CFO had made statements in his interview with the Empire attorneys that amounted to "confessions" and that conflicted with what he told prosecutors who interviewed him. Judge Haight nonetheless refused to dismiss the indictment because he found that the government's case against the CFO for perjury and obstruction of justice was derived from independent sources, and not from privileged information in the memorandum.

AOL Time Warner

In a recent decision, the U.S. Court of Appeals for the Fourth Circuit held that three former AOL Time Warner employees could not prevent the corporation from waiving the attorney-client privilege when responding to a grand jury subpoena for interview memoranda generated during an internal investigation.[4] The investigating attorneys had told the employees that they could represent them as long as no conflict arose. The employees claimed that the investigating attorneys represented them personally during their interviews and made a motion to quash. The district court denied their motion and a unanimous panel of the court of appeals affirmed, finding that all of the "essential touchstones for the formation of an attorney-client relationship between the investigating attorneys and the appellants were missing at the time of the interviews." The Fourth Circuit also cautioned, however, that its "opinion should not be read as an implicit acceptance of the watered-down '*Upjohn* warnings' the investigating attorneys gave the appellants. It is a potential legal and ethical mine field."

The facts giving rise to the Fourth Circuit's holding are straightforward. In March 2001, AOL Time Warner hired an outside law firm to work with in-house lawyers to conduct an internal investigation concerning AOL's relationship with another company. During the course of the investigation, the lawyers interviewed the three employees who later made the motion to quash, following "essentially the same protocol" as to *Upjohn* warnings with all three. In addition to telling the employees that, unless there was a conflict, "we can represent [you]," they also gave the following standard and frequently used warning: "We represent the company. These conversations are privileged, but the privilege belongs to the company and the company decides whether to waive it." The attorneys also told at least one of the employees that he was "free to consult with [his] own lawyer at any time." That employee asked if he needed personal counsel; one of the outside counsel told him that he did not recommend it, but that he would tell the company not to be concerned if the employee did retain counsel.

In concluding that "appellants could not reasonably have believed that the investigating attorneys represented them personally," the court of appeals looked to two "essential touchstones." First, the court found "no evidence of an objectively reasonable, mutual understanding that the appellants were seeking legal advice from the investigating attorneys or that the investigating attorneys were rendering personal legal advice." The court further noted that "[a]n individual's subjective belief that he is represented is not alone sufficient to create an attorney-client relationship." Second, in light of the attorneys' disclosures that they represented AOL and that the privilege and the right to waive it were AOL's alone, the court could not find "investigating counsel's hypothetical pronouncement that they could represent appellants sufficient to establish the reasonable understanding that they were representing appellants." Or, put more succinctly, "'we can represent you' is distinct from 'we do represent you.'" The attorneys' loyalty to the company was made plain in their statements to the employees; that loyalty, the court found, "was never implicitly or explicitly divided." This represents a rather naive depiction of the state of mind of an employee whose conduct is being questioned by the boss's representatives.

After noting that "watered-down" *Upjohn* warnings will not do, the court chided counsel for indicating that they in fact could have represented any of the employees. The court stated that it would be "hard pressed to identify how investigating counsel could robustly investigate and report to management or the board of directors of a publicly traded corporation with the necessary candor if counsel were constrained by ethical obligations to individual employees."[5] The breadth of this statement raises implications as to the propriety of corporate counsel ever representing an employee of a public company.

Rite Aid Corp.

In June 2002, three former executives of the Rite Aid Corp., CEO and chairman Martin L. Grass, general counsel Franklin C. Brown and Eric S. Sorkin, an executive vice president, were indicted in the U.S. District Court for the Middle District of Pennsylvania for, among other charges, conspiracy to obstruct justice based in part on actions they took to mislead internal investigators.[6] Specifically, they were charged with (1) providing false and misleading information to Rite Aid's internal investigators; (2) withholding and concealing material information from Rite Aid's internal investigators; and (3) intimidating, threatening, misleading and corruptly persuading others to provide false information to Rite Aid's internal investigators. They were also accused of the same actions with respect to the SEC and FBI.

According to the indictment, beginning in November 1999, Rite Aid's board of directors directed an outside accounting firm to look into accounting issues; in December, the board retained a law firm to conduct a "massive internal investigation." Among the defendants' actions enumerated in the indictment that allegedly gave rise to the conspiracy to obstruct justice charges were the following: (1) defendant Brown "coached" defendant Sorkin "as to what to tell the attorneys," speaking to him for "hours and hours;" (2) defendant Grass "submitted a 16-page letter containing false and misleading information regarding the matters under investigation to the Company's internal investigators;" (3) Grass and Brown "encouraged [Grass' replacement as CEO] to withhold information from Rite Aid's internal investigators."

Mr. Grass pleaded guilty to conspiracy to commit securities fraud and to obstruct justice and Mr. Sorkin pleaded guilty to one count of conspiracy to obstruct justice. Mr. Brown was convicted at trial of, among other charges, conspiracy to obstruct justice.[7]

Computer Associates

In April 2004, the former CFO and two former executive vice presidents of Computer Associates International Inc., a Long Island-based computer software company, pleaded guilty in the U.S. District Court for the Eastern District of New York to securities fraud and obstruction of justice charges. Unlike the Rite Aid matter, the obstruction charges against the three Computer Associates officers stemmed only from statements they made to internal investigators—there were no allegations of the Computer Associates officers directly misleading the government or grand jury. The *Computer Associates* case also differed from the *Rite Aid* matter in that the government attempted to link the act of misleading internal investigators with misleading federal investigators; the criminal informations in the *Computer Associates* case alleged that the defendants not only misled internal investigators, but did so knowing and intending that the attorneys "would present these false and misleading justifications to the United States Attorney's Office, the SEC and the FBI," which "would have the effect of obstructing and impeding the Government Investigations."[8]

In early 2002, the United States Attorney's office for the Eastern District of New York, the FBI and the SEC began an investigation of the accounting practices of Computer Associates. The company hired a prominent law firm to conduct an internal investigation; a year later its board of directors' audit committee hired a second large law firm as well. The three officers—David Kaplan, David Rivard and CFO Ira Zar—were accused of misleading lawyers from both firms. Specifically, the informations allege that the defendants went to great lengths to mislead outside counsel about a practice—known within the company as the "35-day month"—whereby the company would artificially extend months beyond the true end of the month for accounting purposes. Kaplan, Rivard and Zar were alleged to have "concocted" and presented to the lawyers "an assortment of false and misleading justifications the purpose of which was to counter or explain away evidence of the 35-day month practice." The informations against Mr. Kaplan and Mr. Zar indicate that they also plotted and agreed in advance of their interviews and those of other executives that they and the others would deny to the internal investigators the existence of the 35-day month practice. Mr. Zar was further accused of "encourag[ing]" a senior vice president, "not to disclose [at his government interview] the existence of the 35-day practice but rather to present various false justifications," which the senior vice president then did.

Prosecutors did not stop with the officers who pleaded guilty in April. In September 2004, the government unsealed an indictment charging Sanjay Kumar, the former CEO and chairman of the board of Computer Associates, and Stephen Richards, the former head of sales, with securities fraud conspiracy, obstruction of justice and conspiracy to obstruct justice. In addition, the former general counsel of the company, Stephen Woghin, pleaded guilty at that time to similar charges.[9] The charges against Kumar, Richards and Woghin echoed those against Kaplan, Rivard and Zar. During meetings with outside counsel, they allegedly failed to disclose, falsely denied and concealed the existence of the 35-day month practice, knowing and intending that the lawyers would present this information to the government. Mr. Kumar also was alleged to have frequently instructed Mr. Woghin, the general counsel, to meet with employees before their interviews by the government or the company's lawyers to "coach" them on how to answer questions without disclosing the 35-day month practice. Mr. Kumar also allegedly coached employees himself on several occasions. Unlike the others, Mr. Richards was charged with perjury in connection with his SEC testimony and Mr. Kumar was charged with making false statements to the FBI and United States Attorney's office. Mr. Kumar is scheduled to go to trial next year.

Necessary Warnings

All of these cases make clear that lawyers conducting internal investigations need to be extremely careful in phrasing the warnings they give before interviewing corporate employees.

A laundry list of some of the issues counsel might seek to address is:

1. who the interviewing attorneys represent and who they do not represent;
2. the attorney-client privilege and waiver issues raised by who they represent;
3. the likely use and dissemination of the information gathered during the course of the investigation;
4. the law enforcement implications of the interviews;
5. joint defense status, if relevant;
6. right to counsel on the part of the employee.

Obviously, the severity of the warnings increases the possibility of a refusal to be interviewed which defeats a major goal of the corporate client to be perceived as supplying valuable information to the prosecution. Striking the right balance between fairness and protection of the corporate interest has become difficult for "deputized" corporate investigators.

1. 449 U.S. 383 (1981).

2. See, e.g., Brian Quinton, "SOX, Lies and Privilege: Who Is the Client?", Corp. Legal Times, September 2004; Tamara Loomis, "DOJ Encourages Waiving Attorney-Client Privilege," N.Y.L.J., Feb. 21, 2003.

3. No. S2 94 Cr. 760 (CSH), 1996 WL 751386 (S.D.N.Y. 1996) (redacted opinion); see also No. S1 94 Cr. 760 (CSH), 1996 WL 737042 (S.D.N.Y. 1996) (redacted opinion).

4. *In re Grand Jury Subpoena,* 415 F.3d 333 (4th Cir. 2005).

5. The court also found that a joint defense or common interest agreement AOL's attorneys entered into with one of the employees did not preclude AOL's waiver of the attorney-client privilege because the agreement was not entered into until after the relevant interviews had already occurred.

6. See Indictment, *United States v. Grass* (M.D. Pa. June 21, 2002) (available at www.usdoj.gov/dag/cftf/charging-docs/grassetalind.pdf). A fourth former Rite Aid executive, Franklyn M. Bergonzi, was indicted at the same time as Grass, Brown and Sorkin; he was not accused of misleading internal investigators. Grass and Brown also were indicted for securities and accounting fraud, witness tampering and making false statements to the SEC. Mr. Sorkin also was indicted for making false statements to the grand jury.

7. See "Ex-Lawyer for Rite Aid is Found Guilty," N.Y. Times, Oct. 18, 2003; "Rite Aid Case," Phila. Inq., June 27, 2003; "Ex-Chief Pleads Guilty in Rite Aid Case," N.Y. Times, June 18, 2003.

8. Information, *United States v. Zar,* No. 04-331 (ILG) (EDNY April 8, 2004); Information, *United States v. Kaplan,* No. 04-330 (ILG) (EDNY April 8, 2004); Information, *United States v. Rivard,* No. 04-329 (ILG) (EDNY April 8, 2004) (available at www.usdoj.gov/dag/cftf/chargingdocs).

9. Indictment, *United States v. Kumar* (EDNY Sept. 22, 2004); see also DOJ Press Release, "Former Computer Associates Executives Indicted on Securities Fraud, Obstruction Charges," Sept. 22, 2004 (available at usdoj.gov/opa/pr/2004/September/04_crm_642.htm). The government also entered into a deferred prosecution agreement with the company at that time.