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Remediation Center: Whistleblower Rules and Attorney-Client Privilege

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At the request of subscribers, Compliance Week offers a Remediation Center, in which readers can submit questions—anonymously—to securities and accounting experts. Compliance Week's editors will review all questions and then submit them—confidentially, of course—to specialists who can address the issues. The questions and responses will then be reprinted in a future edition of Compliance Week. Below is one of the Q&As; ask your own questions by clicking here.

QUESTION

I know the SEC hasn't yet adopted final new rules for whistleblower rewards and protections, but I'd like to begin panicking over them now. Let's say I'm in the preliminary stages of investigating a possible fraud and haven't yet alerted the SEC. An unhappy employee, meanwhile, has gone running to the agency sounding the alarm, and now an enforcement lawyer is on the phone asking me questions.

My questions to you: Would I need to (or be expected to, or be subtly pressured to) waive attorney-client privilege to help the SEC investigate the whistleblower's allegations? How can I politely tell the agency that I'm investigating this on my own and don't know much? I don't want to get railroaded by some whistleblower trying to force my hand prematurely.

ANSWER

No matter the specific whistleblower rules that the SEC ultimately promulgates, employees will have powerful financial incentives to report even merely suspected misconduct directly to the SEC.

Your first question is whether, when a company is conducting an internal investigation, the SEC will expect the company to waive the attorney-client privilege relating to the investigation. Don't expect a direct or implied request for a privilege waiver from the SEC enforcement staff. Generally, under the SEC's current enforcement program, the SEC staff does not seek such waivers. In fact, Section 4.3 of the SEC Enforcement Manual expressly says: “The staff should not ask a party to waive the attorney-client privilege or work product protection without prior approval of the director or deputy director.” That same section further provides with specific respect to internal

ABOUT THE EXPERT


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investigations that a failure to waive the privilege doesn't mean the company will be viewed as uncooperative:

To receive cooperation credit for providing factual information obtained from the interviews, the corporation need not necessarily produce, and the staff may not request without approval, protected notes or memoranda generated by the attorneys' interviews. ... A party's decision to assert a legitimate claim of attorney-client privilege or work product protection will not negatively affect their claim to credit for cooperation.

Your second question is very pragmatic: How do you deal with the SEC while you are conducting your own investigation? In most circumstances the SEC staff will (to conserve its own resources) defer its own investigation to an internal investigation being conducted by a company. Of course, this deference, of course, critically depends on the SEC staff being comfortable with the scope, objectivity, and thoroughness of the company's internal investigation. Hence in most cases involving possibly serious misconduct, such as potential accounting fraud, investigations are conducted under the auspices of a committee of independent directors with independent, outside counsel.

If the staff defers its investigation until the company's own internal investigation concludes, it will expect a report on the results of that internal investigation and will generally make charging decisions based on those results alone, or based on the company's investigation and any follow-on investigation the SEC staff feels is appropriate. This is a very common course of events.

If for some reason, however, the staff decides to conduct its own probe at the same time the company is conducting its internal investigation, the SEC Enforcement Manual requires those investigations to be *parallel*—not joint. This means the SEC staff would be precluded from coordinating its investigation with the company. The SEC staff would not take any investigative measures principally for the benefit of the company. Neither would the staff suggest any investigative steps to the company.

In parallel investigations—which, again, are not the norm—the company would undertake its own internal investigation at the same time it deals with and responding to an investigation by the SEC of the same underlying facts and circumstances. Responding to parallel investigations would be highly disruptive and costly, but the existence of two investigations would also risk inconsistent findings and conclusions.

The best way to avoid this situation is for the company to conduct a credible investigation. That requires, among other things: (i) the recusal of any person whose conduct is in question from being involved in the investigation; (ii) an appropriate and expressly articulated scope of the internal investigation; (iii) an investigator (such as an independent, outside law firm) with credibility with the SEC; (iv) a thorough and well-documented process; and (v) possible periodic reports to the SEC staff on the progress of the internal investigation.