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'Kozlowski': Using Internal Probes Against Employees?

A corporation that learns of potential wrongdoing by its employees or agents may undertake an internal investigation. The investigation may lead the corporation to stop the wrongdoing, if there is any; it may also demonstrate to the government the corporation's good faith and cooperativeness, and thus help the corporation to avoid prosecution.

The corporate internal investigation is a boon for the government because it does the government's work for it: Not only is the wrongdoing stopped, but if the corporation provides the government with the results of its internal investigation, then the government has a road map for prosecution.

Three Recent Developments

Recent months have seen three developments that may affect how corporate internal investigations are conducted and how their results might be used in criminal trials. On Aug. 28, the U.S. Department of Justice promulgated a memorandum entitled "Principles of Federal Prosecution of Business Organizations," referred to as the "Filip Memorandum," which provided, in substance, that in making charging decisions with respect to the corporation the government could not consider whether the corporation had waived its attorney-client privilege (although the government could consider whether the corporation had disclosed "facts known to the corporation about the putative criminal conduct under review"). The memorandum further provided that in making charging decisions, the government could not take into account whether the corporation had advanced attorney's fees to its employees or whether the corporation had entered into a joint defense agreement.¹

On the same day, the U.S. Court of Appeals for the Second Circuit issued its decision in *United States v. Stein*,² in which the court held that the government had violated the Sixth Amendment right to counsel of 13 former KPMG partners and employees when it threatened KPMG with adverse consequences if it continued to advance attorney's fees to those partners and employees. In light of its finding, the court affirmed the dismissal of the



The Filip Memo and 'Stein' are seen as "prodefendant" because they give protection against criminal prosecution to employees.... But 'Kozlowski' underlines how a corporate probe can be used... against employees.

indictment against the 13 partners and employees. Both the Filip Memorandum and *United States v. Stein* are the subject of an earlier Outside Counsel article.³

'People v. Kozlowski'

The third development occurred on Oct. 16 when the New York Court of Appeals decided the case of *People v. Kozlowski*, which arose out of the prosecution of former Tyco CEO Dennis Kozlowski and former Tyco CFO Mark Swartz. The two men were indicted for larceny, fraud and falsification of business records, arising principally out of the extraordinary bonuses that they received while in their positions. Tyco had retained a law firm (Boies,

Schiller & Flexner) to do an internal investigation, and the lead lawyer involved in the investigation, David Boies, was a government witness, testifying extensively about the investigation. Mr. Boies testified about his own background, including his experience conducting internal investigation, about statements made to him by one of the defendants (Mr. Swartz), and about his (Mr. Boies') conversations with the board of directors about the investigation. Mr. Boies testified that he had provided Tyco's CEO with facts and information that, he testified, carried an "inherent" recommendation that Mr. Swartz should be fired. The defendants were convicted, and their convictions were affirmed by the Appellate Division.

Defendants argued on appeal that Mr. Boies' testimony constituted an impermissible expert opinion that the defendants were guilty. The defendants argued that the government elicited Mr. Boies' background in such a way as to establish him as an expert in internal investigation, and then elicited from him testimony that he had conveyed an "inherent" recommendation that Mr. Swartz should be dismissed. The combination, argued the defense, effectively added up to an expert's saying that Mr. Swartz had behaved wrongly, i.e., was guilty.

The Court of Appeals rejected the argument. It determined that Mr. Boies' background testimony "provide[d] helpful context for the jury about [a] complex subject matter... an internal investigation." It concluded that Mr. Boies' testimony about his conversations with the board was "limited to a first-hand factual account," and that his testimony about the "inherent" recommendation that he made to the Tyco CEO was an appropriate rebuttal to Mr. Swartz' argument that the "board stood behind him even after it learned of his alleged improprieties."

Defendants also alleged error in the trial court's quashal of a subpoena issued by the defendants to the Boies Schiller firm. The subpoena sought "[a]ll memoranda and notes of [the firm's] personnel (or forensic accountants working on their behalf) relating to interviews of employees, directors or auditors of Tyco." The trial court quashed the subpoena and the Appellate Division affirmed, holding that the trial court "did not improvidently exercise its discretion."

The Court of Appeals considered the propriety of the quashal order only insofar as it pertained to three of the documents sought by defendants, namely

notes of Boies Schiller's interviews of directors-witnesses.⁴ As to these documents, the Court of Appeals held that the quashal order was wrong, in that the defendants had satisfied the burden set forth in *People v. Gissendanner* for enforcing third-party subpoenas because they had "identified specific director-witness statements and proffered facts that permitted an inference that those statements were reasonably likely to contain material that could contradict the statements of key [witness] for the People."

The Court of Appeals ruled, however, that the notes of the interviews of the director-witnesses were covered by the attorney work product doctrine because they "were prepared to assist Tyco's preparation for civil litigations that eventually commenced." The Court of Appeals further held that these materials were not "absolutely privileged work product," but merely "conditionally privileged trial preparation materials," to which the defendants would be entitled upon a showing that they could not "obtain the substantial equivalent" of the information elsewhere "without undue hardship." The Court held that the defendants had not satisfied that standard because they had not demonstrated that they were unable to interview the same directors.

The final question for the Court of Appeals, therefore, was whether there had been a waiver of the work product protection as to the notes of the interviews of the director-witnesses. The Court of Appeals held that Tyco's waiver of the privilege with respect to other documents that were "unrelated to the director-witness statements" did not constitute a waiver as to the director-witness statements. Relying on representations by the government and Tyco that the substance of the director-witness statements had not been divulged to the government, the Court of Appeals further held that Tyco's cooperation with the government had not constituted a waiver as to those statements. Finally, in rejecting the defendants' argument that Mr. Boies' testimony had constituted a waiver, the Court of Appeals stated that Mr. Boies' testimony had been "limited to facts," and that Mr. Boies did not "seek to bolster his arguments with the aid of the relevant director-witness statements."

Key 'Kozlowski' Points

The Filip Memorandum and *United States v. Stein* are both widely perceived as "prodefendant" developments because they provide some protection against criminal prosecution to employees whose employers have conducted internal investigations. *People v. Kozlowski*, however, underlines how a corporate investigation can be used in a criminal prosecution against employees.

Three aspects of the case are especially noteworthy.

- **First**, the decision demonstrates the allowable breadth and considerable persuasive power of the testimony of the persons leading the investigation. After the prosecutor elicited Mr. Boies' sterling credentials and extraordinary experience, the jury could not have avoided giving great weight to Mr. Boies' testimony about the investigation (much of which was conducted under his direction but not by him personally), and in particular to his testi-

mony that the report to the Tyco CEO carried an "inherent recommendation" that Mr. Swartz should be fired.

Mr. Boies was a case agent and an expert rolled into one, and the potential prejudice caused by such witnesses is well-recognized.⁵ As the Second Circuit has stated: "[W]hen a fact witness or a case agent also functions as an expert for the government, the government confers upon him 'the aura of special reliability and trustworthiness surrounding expert testimony, which ought to caution its use.'"⁶ In fact, the testimony of one like Mr. Boies who is not a government agent may be even more powerful than that of a case agent, because Mr. Boies did not represent a party in the criminal case and thus was not subject to a charge of bias.

- **Second**, one critical part of the Court of Appeals' decision with respect to the defendants' right to obtain Boies Schiller's notes of the interviews of the director-witnesses was its finding that the defendants had not demonstrated that they could not have interviewed the witness directors themselves.

The fact is, however, that in most cases the defendants would never be able to interview those director-witnesses. Unlike the government and the company itself, the defendants would have no means of compelling the directors-witnesses to submit to an interview or to provide testimony.

Furthermore, whereas, even absent compulsion, the directors would have an incentive to cooperate with the government and the company, they would have no incentive to respond similarly to requests from the defendants. After all, by the time the defendants would have reason to speak with the directors-witnesses, the defendants would already be *personae non gratae*—either under indictment or, at the very least, under grave suspicion. Thus, the Court of Appeals' reliance on the theoretical availability of the directors-witnesses to the defendants appears to be misplaced.

- **Finally**, the Court of Appeals' holding that there had been no waiver with respect to the notes of director-witness interviews may indicate an unduly narrow and technical definition of waiver. Tyco had a close working relationship with the prosecutors; according to Mr. Boies the Boies Schiller attorneys "consult[ed] regularly with the District Attorney's Office about the proceedings" and would "certainly respond to any questions that the District Attorney's Office ha[d]." The court held that there was no waiver, however, because Mr. Boies' testimony had been "limited to facts" and had not been "bolster[ed]" by the statements of the director-witnesses, and because the government and the Boies Schiller attorneys represented to the court that the substance of the director-witness statements had not been divulged to the government.

The investigators could, however, provide information that they derived from director-witness statements without divulging the statements themselves, and, under the Court of Appeals' test, the provision of such information would not effectuate a waiver.

The conclusion may elevate form over substance.

If the director-witnesses were the sole or most significant source of information, whether there is a waiver with respect to their interview notes ought not to depend on whether or not the investigators expressly attributed the information to the director-witnesses when they provided the relevant information to the government.

Yet that is the distinction suggested by the Court of Appeals' decision. Of course, this problem is not new. As noted above, the Filip Memorandum relies upon the same distinction: The government may not require a waiver of the attorney-client privilege, but it may demand the underlying facts known to the corporation. "The obvious problem is that the 'facts' uncovered in an internal investigation are actually an attorney's distillation of numerous interviews and documents and therefore work product."⁷

Conclusion

In the wake of the Filip Memorandum, *Stein* and *Kozlowski*, corporate internal investigations will continue to play a central role in white-collar prosecutions. Corporations may still, notwithstanding the DOJ's new guidelines and the Second Circuit's delineation of employees' Sixth Amendment rights to counsel, choose to cooperate closely with prosecutors. *Kozlowski* shows how potent such cooperation may be.



1. See "Principles of Federal Prosecution of Business Organizations," Memorandum from Mark R. Filip, Deputy Attorney General, to Heads of Department Components and United States Attorneys (Aug. 28, 2008), available at <http://www.usdoj.gov/opa/documnets/corp-charging-guidelines.pdf>.

2. 541 F.3d 130 (2d Cir. 2008).

3. Mark J. Stein and Joshua A. Levine, "The Filip Memorandum: Does It Go Far Enough?" NYLJ Sept. 10, 2008.

4. In the trial court, in response to the government's contention that the subpoena was overbroad as written, the defense limited the subpoena by identifying 72 documents from a privilege log that Tyco had prepared for certain civil litigation. Tyco provided four of those 72 documents (these were notes and memoranda describing interviews with defendant Swartz), but continued to resist production of the other 68 documents. The Court of Appeals discussed only three of these documents. It appears that the Court of Appeals upheld without discussion the quashal of the subpoena insofar as it related to the other 65 documents.

5. See, e.g., *United States v. Cruz*, 363 F.3d 187, 193-97 (2d Cir. 2004); *United States v. Dukagjini*, 326 F.3d 45, 53 (2d Cir. 2002).

6. *United States v. Dukagjini*, 326 F.3d at 53 (quoting *United States v. Young*, 745 F.2d 733, 766 (2d Cir. 1984) (Newman, J., concurring)).

7. Mark J. Stein and Joshua A. Levine, "The Filip Memorandum: Does It Go Far Enough?," *supra*.