

## OUTSIDE COUNSEL

BY DAVID B. FEIN AND ROBERT HOFF

### *Internal Investigations: Hewlett-Packard's Lessons*

**E**nron and the ensuing corporate scandals taught serious lessons about corporate governance, including ethics, independence and accountability.

In the last five years, enforcement actions against companies and their executives have spotlighted negligent, reckless and criminal conduct. Many of those enforcement actions, brought by the Justice Department and the Securities and Exchange Commission (SEC), have targeted corporate counsel based on actions they took—or did not take—in representing their clients, including in conducting internal investigations.

In a 2004 speech on “the fundamental significance of gatekeepers in maintaining fair and honest markets,” the SEC’s then-Enforcement Director Stephen Cutler explained that the SEC was “concerned that, in some instances, lawyers may have conducted investigations in such a manner as to help hide ongoing fraud, or may have taken actions to actively obstruct such investigations.”

The Hewlett-Packard pretexting fiasco of 2006 demonstrates that many of the hard-learned lessons of the Enron era still need repeating and relearning.

This article will address four fundamental issues in counsel’s role in conducting internal investigations, and identify how they were handled, or potentially mishandled, at Hewlett-Packard. First, who is the client? Second, who should conduct a public company’s internal investigation, in-house or outside counsel? Third, what is counsel’s role in overseeing the investigation? And fourth, what is the role of corporate attorney-client privilege?

#### Who Is the Client?

Counsel must identify the client at the outset of any matter. In most cases, the client is the corporation. As a result, in conducting interviews with corporate executives and employees, counsel must explain who the client is—and who it is

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not—so that interviewees cannot reasonably assume that counsel represents them. Failure to do so can result in the interviewees becoming stakeholders in the product of the interviews, jeopardizing the company’s ability to use the information in its own best interests.

When the conduct of senior management or board members is at issue, special care must be taken in identifying to whom counsel reports and from whom counsel takes direction. Conflicted board members, senior executives and counsel should be removed from the consultation so the client is embodied in nonconflicted individuals.

A board leak investigation, as in the case of Hewlett-Packard, puts in question the conduct of all board members, as well as senior management that attended board meetings. Special procedures are therefore required to identify conflict-free individuals who can serve as the corporate client. In the Hewlett-Packard investigations, Board Chairwoman Patricia Dunn was both a subject of the investigation and a corporate leader playing some role in the direction of the investigations.

#### Conducting the Internal Probe

• **Who should conduct a public company’s internal investigation?**

In considering who should conduct a public company’s internal investigation, companies should weigh the advantages and disadvantages of retaining outside counsel. For serious or complex matters, outside counsel can offer two important advantages: (1) investigative expertise, and (2) independence. Many law firms have former prosecutors who

maintain an active practice of government and internal investigations, matters that are not the traditional bailiwick of most in-house counsel. And outside counsel who have no relationship with the subjects of the investigation are often perceived by the government and the public as more objective and reliable fact-finders.

Of course, regular outside counsel can present independence issues. Regular outside counsel may have provided legal advice on—or been witnesses to—matters under investigation. They may have close or ongoing professional relationships with those whose conduct is under review. Regular outside counsel may also be corporate lawyers with little or no investigations experience.

In August 2001, Enron retained its regular outside counsel, Vinson & Elkins (V&E) to investigate Sherron Watkins’ allegations of accounting fraud. The result was a one-month inquiry that found no wrongdoing. Yet Ms. Watkins had specifically urged that V&E not be selected because it had represented Enron in connection with many of the matters she challenged. The final report of Neal Batson, the court-appointed Enron examiner, determined that a fact-finder could conclude that V&E committed malpractice by, among other things, failing to inform Enron of its conflict of interest in conducting the investigation.

At Hewlett-Packard, twice investigators were chosen to pursue board leaks but in neither instance was independent outside counsel chosen. Initially, Larry Sonsini was asked to investigate the leaks. Mr. Sonsini interviewed directors but was unsuccessful in identifying the source of the leaks. Mr. Sonsini had been outside counsel to the company long before the board leaks and presumably had counseled the individuals under investigation.

Later in 2005, newly elected Board Chairwoman Patricia Dunn continued pursuing the source of the board leaks. Ms. Dunn did not retain outside counsel to oversee the investigation. Instead, she turned to an internal group within the company, including the company’s General Counsel Ann Baskins. Ms. Dunn apparently recommended that Kroll Associates oversee the investigation, but Ms. Baskins said it should be handled internally, led by in-house senior counsel and ethics director Kevin Hunsaker.

The decision to proceed internally, unaided by experienced and independent outside counsel, raises serious questions. How could the company's general counsel oversee an investigation of the company's board of directors, whom she counseled and served as corporate secretary? Were not Ms. Dunn and Ms. Baskins witnesses and participants at the very board meetings from which the leaks sprang, and therefore potential sources of the leaks? Indeed, Ms. Dunn has stated that her knowledge of the investigation's methods was limited because she was a subject of the investigation.<sup>1</sup> Were Ms. Dunn, Ms. Baskins and Mr. Hunsaker competent to oversee a complex leak investigation?

The desire to avoid outside counsel should itself set off alarm bells. In the case of AIG and Gen Re (in which Gen Re's former in-house attorney, Robert Graham, has been indicted along with others from his company and AIG), the indictment charges that the former CEO of a Gen Re affiliate requested that Mr. Graham review a draft of the transaction document, and to "bear in mind my lack of legal knowledge and the fact we have tried to avoid any lawyers being involved elsewhere to keep the circle to a minimum."<sup>2</sup>

### Counsel's Role as Overseer?

#### • What is counsel's role in overseeing the investigation?

When in-house counsel decides to run an investigation internally, they should determine what role to play in the conduct of the investigation. In today's environment, it is not enough for an in-house attorney to manage passively, relying on others to do things right. In-house counsel should satisfy themselves that the investigation is being conducted lawfully and appropriately, and they should share their advice, and all its risks, with the relevant decision-makers.

The SEC's enforcement action against Google's general counsel, David Drummond, in 2005 exemplified the problem of counsel limiting its role in a matter. In that case, Mr. Drummond consulted with outside counsel and counsel within Google's legal department and determined that a particular course of action was legal. He advised the board that it could proceed, but did not identify the risks inherent in the conduct, about which he was aware. The SEC later determined that Mr. Drummond's failure to advise the board of the risks caused the company to run afoul of the securities laws. The SEC brought a cease-and-desist proceeding against Mr. Drummond and Google.

Publicly available information suggests that Hewlett-Packard's legal department was never fully comfortable that the investigative techniques were legal yet they apparently did not inform the client of their uncertainty. As Ms. Baskins' own lawyers wrote to Congress, she inquired about the legality of the investigative techniques on at least four occasions between 2005 and May 2006. On Jan. 30, 2006, when Mr. Hunsaker was advised by an investigator, "I think it [pretexting] is on the edge, but above board," Mr.

Hunsaker replied, "I shouldn't have asked."<sup>3</sup>

A company should obtain a comprehensive analysis of the legality of investigative methods at the outset of the investigation, not months or years later, and the opinion should come from a competent, independent firm. In-house counsel should share that advice with the client so that the client can make an informed decision on how to proceed.

### Attorney-Client Privilege

#### • What is the role of corporate attorney-client privilege in internal investigations?

Issues regarding corporate attorney-client privilege present complex problems for counsel managing internal investigations. Corporations cannot shield all communications concerning an internal investigation simply by involving an attorney in corporate decision-making. For in-house counsel, who often wear multiple hats, it is especially important to determine if they are serving a legal advisor function. When Mr. Hunsaker offered to oversee the leak investigation in an e-mail to Ms. Baskins, he wrote, "[i]n order to ensure we can rely upon the privilege if anything ever comes of this, would you like me to oversee the investigation?"<sup>4</sup> But the involvement of an attorney does not, by itself, create privilege.

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Indeed, trying to create privilege where one does not exist can itself constitute wrongdoing. In the KPMG tax shelter matter, the federal indictment alleged that the defendants tried to "cloak" communications with the attorney-client privilege by creating sham *Kovel* arrangements.<sup>5</sup> Additionally, KPMG was previously excoriated by a federal judge for improper assertions of the attorney-client privilege.

One of the most important issues facing the entire legal community presently is the status of corporate attorney-client privilege in the context of government investigations. The Department of Justice's Thompson Memorandum has come under attack recently, including from the American Bar Association and former high-ranking members of the Department of Justice, for its alleged creation of a "culture of waiver," where companies are expected to waive the attorney-client privilege during a government investigation. At the moment, waiver is still prevalent, and one needs to look no further than the Hewlett-Packard matter. Many of Ms. Baskins',

Mr. Hunsaker's and Mr. Sonsini's communications are now in the public domain, as are several of Wilson Sonsini's memoranda of witness interviews conducted in August 2006. In-house counsel cannot take comfort in the fact that their communications are—at the moment—privileged.

Heed the lesson of a former Enron in-house attorney, who had previously instructed other company attorneys to put his name on a memo to make it "more privileged." Enron later waived its attorney-client privilege and the memo became publicly available. The experience taught him to ask when writing or saying something, "[H]ow will a judge interpret these words?" Or better still, "[H]ow will an ambitious, 35-year-old assistant U.S. attorney interpret them?"

### Conclusion

The Hewlett-Packard "pretexting" investigation took the legal and business communities by surprise in 2006. The story shows that leaders at even the most successful companies can exercise poor judgment in the area of corporate compliance and corporate governance. Sometimes the ends obscure the means, especially when the request for results comes from on high. Yet it is in-house counsel's responsibility to their client, and to themselves, to serve as a check on the desire for results when those results will be achieved by questionable means.

As Warren Buffett recently told his senior management, "[L]et's start with what is legal, but always go on to what we would feel comfortable about being printed on the front page of our local paper, and never proceed forward simply on the basis of the fact that other people are doing it."<sup>6</sup>

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1. Joann S. Lublin and Peter Waldman, "Divided H-P Board to Discuss Leak Scandal, Dunn's Future," Wall Street Journal, Sept. 9, 2006, at A1.

2. *United States v. Ferguson, et al.*, 3:06-CR-137(PCD) (D. Conn.) (Superseding Indictment 44(jjj)).

3. E-mail exchange between Kevin Hunsaker and Anthony R. Gentilucci, Jan. 30, 2006, 12:00 p.m. and 12:33 p.m.

4. E-mail from Kevin Hunsaker to Ann Baskins, Jan. 20, 2006, 5:55 p.m.

5. Pursuant to the U.S. Court of Appeals for the Second Circuit's *Kovel* decision, communications with nonlawyer professionals, such as accountants, are protected under the attorney-client privilege when the professional is providing special expertise to an attorney to enable the attorney to dispense legal advice.

6. Karen Richardson, "Buffett Says to Avoid Scandals, Managers Must Not Follow Herd," Wall Street Journal, Oct. 10, 2006, at A9.