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Cases Highlight Minefield In Internal Investigations

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March did not go out like a lamb for white-collar lawyers conducting internal investigations. Late in the month, a purported "client" of Proskauer Rose - the former chief investment officer of Stanford Financial Group - sued the law firm and one of its partners for malpractice, claiming that their negligence led to the filing of a criminal charge against her. Less than a week later, a federal judge in California referred the Irell & Manella firm to the State Bar for "appropriate discipline." This is what can happen when lawyers represent corporations in connection with suspicions of wrongdoing, and simultaneously deal with, and arguably represent, officers of those corporations. Although the former Stanford executive withdrew her action without prejudice on April 9, 2009 (for reasons undoubtedly relating to the primacy of the criminal case), damage was still done and there are lessons to be learned.

These cautionary tales, involving seasoned lawyers from prominent firms, present a fine time for revisiting the U.S. Court of Appeals for the Second Circuit's 1997 *Teamsters* decision and best practices concerning so-called *Upjohn* warnings to employees during internal investigations.¹ It has never been as important to be clear and direct when interviewing employees, and to memorialize advice given about the interviewer's relationship with the subject.

As the court urged counsel in *Teamsters*, "attorneys in all cases are required to clarify exactly whom they represent . . ." Recognizing that frank warnings to employees can be, frankly, frightening and impede investigative efforts, these cases nevertheless underscore the professional perils of giving watered-down *Upjohn* warnings and being less than clear about who the client really is.

On April 1, 2009, U.S. District Judge Cormac J. Carney (C.D. Cal.) suppressed former

Broadcom CFO William Ruehle's statements to Broadcom's outside counsel, Irell & Manella, during that firm's internal investigation into company stock option practices.² The judge also referred the firm to the State Bar "for appropriate discipline" for simultaneously representing Broadcom and Mr. Ruehle when it "knew or should have known that Broadcom's interests and Ruehle's interests conflicted and were adverse to each other."

After Broadcom learned in 2006 that it might be investigated by the government and sued for its stock option practices, and retained Irell to conduct an internal investigation, it was sued in two different actions. Mr. Ruehle was also named as a defendant in the actions, and Irell appeared as counsel for both for the first several months of the litigations.

During that time, Irell interviewed Mr. Ruehle in the course of its internal investigation.³ Before the interview commenced, Mr. Ruehle was apparently told merely that the interview was being conducted "on behalf of Broadcom." At Broadcom's direction, but without Mr. Ruehle's consent, the firm subsequently turned over his interview statements to, among others, the U.S. Attorney's Office. He was indicted on June 4, 2008.

Judge Carney found the following ethical missteps: (1) Irell knew or should have known its clients' interests were adverse, but never obtained Mr. Ruehle's informed written consent to the dual representation, as required under California disciplinary rules (ironically, only effective April 1, 2009, the date of the *Nicholas* decision, did New York State begin requiring such written consent)⁴; (2) prior to beginning the interview, Irell lawyers never told Mr. Ruehle that they were representing Broadcom's interests alone in connection with the interview, and that whatever he said to them could be used against him by Broadcom or disclosed to third parties, including federal prosecutors; (3) Irell breached its duty of loyalty to Mr. Ruehle by interrogating him for the benefit of another client, Broadcom; (4) the firm never suggested to him, prior to the interview, that he might want to consult with his own lawyer first (indeed, Judge Carney found that Mr. Ruehle had every reason to believe that Irell lawyers were his own lawyers); and (5) the firm never obtained Mr. Ruehle's consent before making disclosures to third parties, the U.S. Attorney's Office most egregiously. Judge Carney gave short shrift to the lawyers' supposed oral statement to Mr. Ruehle (a purported *Upjohn*) that he was being interviewed "on behalf of Broadcom," finding it misplaced where Mr. Ruehle and Irell had an "undisputed attorney-client relationship" and when *Upjohn* warnings are plainly intended for non-clients.

Malpractice Lawsuit

The New York legal community has been following the alleged R. Allen Stanford "Ponzi" scheme case with great interest, and not only because of Stanford's resemblance to Bernie Madoff. According to press accounts, the scheme was exposed, and an SEC suit commenced, within days of Proskauer partner Thomas Sjoblom's advising the SEC that his firm was withdrawing from representing the Stanford Financial Group and disaffirming all his prior representations to the staff.

Further interest was sparked in late March when the group's former chief investment

officer, Laura Pendergest-Holt, sued Mr. Sjoblom and Proskauer for malpractice and breach of fiduciary duty.⁵ Mr. Sjoblom had appeared beside Ms. Pendergest-Holt at a deposition before the SEC on Feb. 10, 2009. On Feb. 27, 2009, she was arrested on a criminal complaint charging her with obstruction of the SEC's investigation. On May 12, 2009, the grand jury returned an indictment also alleging obstruction at the Feb. 10 deposition. Perhaps because the defense to that criminal case necessarily takes priority, Ms. Pendergest-Holt filed a notice of dismissal without prejudice of the malpractice action on April 9, 2009, stating that she "does not wish to purse these claims at this time against these defendants."

In her amended complaint, prior to withdrawal of the action, Ms. Pendergest-Holt alleged that Mr. Sjoblom and Proskauer "hung her out to dry," leading her to believe that they were representing her at the SEC deposition in an individual capacity, but neglecting to fulfill basic duties attendant to such representation. For example, the complaint alleged that Mr. Sjoblom did not advise her that she had a Fifth Amendment right not to testify, that her communications with him were not privileged, that he could not adequately represent her given conflicts with interests of the Stanford Group, or that she needed separate counsel.

The complaint recounted the following deposition exchange between the staff and Mr. Sjoblom: "[Y]ou do not as far as you're concerned, represent the witness here today?" "I represent her insofar as she is an Officer or director of one of the Stanford affiliated companies." According to the complaint, that statement was consistent with the retainer agreement, which extended the corporate representation to Stanford officers and directors, although not in any individual capacity.

Lessons Learned

With an appeal possibly to be taken in *Nicholas*, and *Pendergest-Holt* dismissed without prejudice, it is far too early, if not practically impossible, to judge the actions of any of the lawyers involved. This author would be loath to do so in any event given the inherent complexities of these situations. That said, it does not take a full-blown record to recognize that there are lessons to be learned:

1. On the one hand, practitioners in the Second Circuit need not be overly fearful of the somewhat subjective "reasonable belief" theory on which Judge Carney's decision relies (that is, corporate counsel will be deemed to have represented an individual employee who has a "reasonable belief" that the counsel is his own).⁶ The Second Circuit explicitly rejected the "reasonable belief" theory in *United States v. International Brotherhood of Teamsters*, where defendant Jere B. Nash III sought unsuccessfully to assert the attorney-client privilege with respect to conversations he had as Ron Carey's campaign manager with counsel to the Carey campaign.⁷ Mr. Nash argued that an employee should enjoy a privilege so long as he "reasonably believed" that he was being represented by corporate counsel on an individual basis.

The Second Circuit rejected this approach, staking out "one extreme" of the case law in this area.⁸ It found no support in the case law for the theory and said that adopting it would be "unwise" in any event. It might "create a personal privilege that could effectively destroy the corporation's ability to waive its own privilege," "provide employees seeking to frustrate internal investigations with an exceedingly powerful weapon," and "stray quite far from the principle that the attorney-client privilege should be 'strictly confined.'"

The Second Circuit regarded the touchstone, instead, as whether or not Mr. Nash had sought or received advice from the campaign's counsel on "personal matters."⁹ It found that he had not.

Even *Teamsters*, though, offers minimal comfort to practitioners in this circuit facing a fact pattern similar to that in *Nicholas*. In one of his many thoughtful decisions in the *Stein* case, Judge Lewis A. Kaplan made the plain observation that the scope of "personal matters" under *Teamsters* is unclear, leaving unanswered whether communications concerning an employee's personal liability for acts within the scope of employment would be covered.¹⁰ If they were, Mr. Ruehle might have won the same relief in the Second Circuit, even under *Teamsters*.

Judge Kaplan also suggested that the privilege might appropriately attach to employee-corporate counsel communications if the employee was "misled" into believing that the communications were subject to a personal privilege, "mak[ing] the employer bear the burden of the employee's erroneous understanding." Much as *Teamsters* remains good law, then, *Stein* suggests that real dangers lurk if a record is created on which an employee could claim that he was misled into a reasonable belief that the company's lawyer also represented him.

2. *Nicholas* illustrates the elementary point that no *Upjohn* warning is sufficient where an employee being interviewed is actually represented by corporate counsel in a litigation or other formal proceeding, jointly with the corporation. In such circumstance, the full panoply of fiduciary duties owed by a lawyer to his or her client attaches, precluding the lawyer, for example, from disclosing the substance of the communications to a third party without consent. Obviously, no lawyer should commit to a dual representation in this context without an understanding of the ramifications for both clients.¹¹

3. Ms. Pendergest-Holt alleged that Mr. Sjoblom stated the following at the deposition: "I represent the individual in their capacity as an officer or director of the corporation." This was evidently inconsistent with her understanding, allegedly based on Mr. Sjoblom and Proskauer's actions and representations, that they were representing her in an individual capacity. The complaint did not specify the alleged "actions" or "representations."

To state the obvious lesson from the complaint, even while we decline to accept the truth of its allegations insofar as they went unanswered and untested, whenever a corporate employee appears to have potential liability of his or her own that may give rise to a conflict, separate counsel should be obtained.

More to the point of this article, even if there is no apparent conflict and a dual representation is undertaken, the employee should be clearly advised what it means to be represented "in their capacity as an officer or director" (for example, "I represent you in connection with the government's investigation into what happened at that Board meeting. If you stole money from your father-in-law, I do not represent you in connection with that. Do you understand the difference?"). The advice should be put in writing, and the retainer agreement should reflect the limited scope of the representation. With the early termination of Ms. Pendergest-Holt's lawsuit, we may never know whether these suggested steps were, in fact, followed there.

Conclusion

The cases discussed here establish that a lack of clarity about the "client" in the attorney-client relationship is perilous in this day and age. At the risk of discouraging cooperation, lawyers should take pains to be clear and direct about whom they represent. They should ensure that any employees being interviewed understand the situation and invite them to ask any questions they may have about it. Even more important than protecting one's reputation and avoiding lawsuits is the lawyer's obligation to ensure he or she does not become an agent of an individual's unwitting self-incrimination in the present-day environment of aggressive prosecutors seeking to take advantage of "waivers" in internal investigation cases.

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Endnotes:

1. *Upjohn* warnings to employees include: explanations that the lawyer represents the corporation, not the employee, that the lawyer is conducting the interview to obtain information to provide advice to the corporation, and that, while the interview is therefore covered by the attorney-client privilege, it is the corporation that controls the privilege and will decide whether to assert it. See *Upjohn Co. v. United States*, 449 U.S. 383 (1981). In the wake of the Computer Associates matter (where criminal obstruction charges were based on statements not to prosecutors, but to outside counsel in internal investigation interviews), many lawyers have expanded the warning to include advice that the corporation may decide to waive the privilege and provide the substance of the interview to third parties, including prosecutors.
2. *United States v. Nicholas*, No. SACR 08-00139-CJC, 2009 U.S. Dist. LEXIS 29810 (C.D. Cal. April 1, 2009) (Mr. Ruehle is a co-defendant in the case). As of this writing, the Solicitor General was still deciding whether to appeal the order.
3. The facts of the *Nicholas* case differ materially from those before Judge Kaplan, when he was asked by former KPMG partner Carol Warley to suppress interview statements she

made to outside corporate counsel in the course of their internal investigation of tax shelters. *United States v. Stein*, 463 F.Supp.2d 459 (S.D.N.Y. 2006). In asserting that the lawyers were also representing her personally, and that her statements to them were therefore privileged, Warley pointed to King & Spalding's joint representation of herself and KPMG in a civil suit involving the same tax shelters. Judge Kaplan concluded "[s]ince that joint representation occurred *after* the communications at issue here and thus could not have any bearing on whether an individual attorney-client relationship existed at the time of these communications, it is not relevant" (emphasis added).

4. Under the old rules, §1200.24 specifically, a lawyer could represent multiple clients if "a disinterested lawyer would believe that the lawyer can competently represent the interests of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved." There was no requirement of a writing. That has now changed. Rule 1.7 provides that notwithstanding a conflict of interest, a lawyer can undertake a dual representation if, among other conditions, each affected client gives informed consent, confirmed in writing.

5. *Pendergest-Holt v. Sjoblom*, No. 3:09-cv-00578-G (N.D. Tex., filed March 27, 2009).

6. Judge Carney relied on a case from the Northern District of California, *Sky Valley Ltd. P'ship v. ATX Sky Valley, Ltd.*, 150 F.R.D. 648 (N.D. Cal. 1993), for the proposition that "[d]etermining whether an attorney-client relationship exists depends on the reasonable expectations of the client." *Nicholas*, 2009 U.S. Dist. LEXIS 29810, at *12.

7. 119 F.3d 210 (2d Cir. 1997).

8. Timothy M. Middleton, "Watered-Down Warnings": The Legal and Ethical Requirements of Corporate Attorneys in Providing Employees With "Upjohn Warnings" in Internal Investigations, 21 *Geo. J. Legal Ethics* 951, 955 (Summer 2008).

9. The decision is consistent with an S.D.N.Y. decision in *In the Matter of a Grand Jury Subpoena Duces Tecum*, 391 F.Supp. 1029 (S.D.N.Y. 1975). Hogan & Hartson represented both Robert Vesco and International Controls Corp. in connection with an SEC investigation. Judge Carter found that while Vesco enjoyed a privilege as to firm documents relating to him "individually and apart from his corporate role," documents concerning matters involving the affairs of the company and his role or activities as an officer or director were producible to the grand jury because of the company's waiver.

10. *Stein*, 463 F.Supp.2d at 465.

11. See *E.F. Hutton & Co. v. Brown*, 305 F.Supp. 371, 387 (S.D. Tex. 1969) ("An attorney's appearance in a judicial or semi-judicial proceeding creates a presumption that an attorney-client relationship exists between the attorney and the person with whom he appears When the relationship is also evidenced by the entry of a formal appearance by the attorney on behalf of the person with whom he appears, the presumption becomes

almost irrebuttable . . . ").