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Practice Management

Tips on managing a corporate crisis



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Law enforcement, the news media, and plaintiff class-action counsel have combined to transform the consequences of a government or internal investigation of a company's suspected violation of the law.

Previously, such investigations were primarily legal problems that in-house and outside counsel handled by investigating the facts, advising management, negotiating with outside entities, and occasionally trying the case.

Today, general counsel need to orchestrate a much broader set of resources in managing investigations into allegations of corporate misdeeds. If not, a small problem can rapidly turn into a corporate crisis.

The ensuing publicity and government sanctions can derail the business agenda of the best management team. Company management, including the general counsel, may be terminated for a variety of reasons based on allegations that they caused the problem, did not foresee it, or they responded inadequately.

This article provides an overview of issues general counsel should consider when handling an alleged violation of the law, and avoiding, or at least managing, a crisis.

A pound of prevention

Companies should have systems that prevent problems or at least detect them at an early stage, i.e., they need effective compliance programs. How to build and maintain a compliance program is beyond the scope of this article.

One point, however, is worth mentioning. Good compliance programs include well-focused, regular audits of the company's risk areas. Audits should be more than just quantitative samplings, and include qualitative reviews. A qualitative audit consists of focus groups or other mechanisms that allow the auditors to have a meaningful dialogue with those persons most knowledgeable about risk areas. It is amazing how much information employees will provide if someone simply asks them.

In addition to a compliance plan, a company should adopt a crisis management plan well before any crisis appears. This allows management to structure its crisis coordination and communication thoughtfully rather than in the heat of the moment.

Responsibilities must be delegated and apportioned: Who will manage the crisis, who will participate

in decision-making, who will get information on the crisis, who will talk to the press, and what will they say.

Recognize the warning signs

General counsel should become attuned to what problems can have significant consequences for their company and identify the most likely sources to discover those problems. Sources may include government subpoenas, internal investigations, routine compliance audits, private lawsuits, data security breaches, or employee complaints on a compliance hotline.

What can be handled routinely? What needs an aggressive response? What should at least be monitored? Once such warning signs come, they may portend the transformation of routine events into dangerous risks. The company may need to take quick action, such as suddenly stopping employee stock trades, or revising routine disclosures to the press and government regulators.

Organize and manage your response

When a significant problem hits, it is inevitable that there is a panic reaction among the management team. The general counsel needs to immediately respond to the problem and control the flow of information to the appropriate recipients only. Controlling information not only protects the company's reputation and legal position, it also limits the gossip and innuendo that can dispirit employees and crater business opportunities.

The general counsel needs to decide if the company can handle the problem in the traditional way, with the general counsel retaining outside counsel and reporting up through the management chain. Or, should the problem be referred to the audit committee or other subcommittee of the board of directors, to investigate with outside counsel wholly independent of company management.

The Sarbanes-Oxley Act has greatly expanded the role for board subcommittees. It is advisable to at least inform the board of any significant problem, and let it decide (or at least reconsider) who will oversee the response.

If an issue is sent to the audit committee, it is important to follow accepted procedures. Audit committee counsel and consultants should be truly independent of the company and management. The board should control the investigation and management should not try to undermine that independence.

For a public company, years after the problem first surfaces, the Securities and Exchange Commission or plaintiff shareholder class action counsel may carefully review the company's reaction to the crisis. An audit committee's failure to follow accepted procedures may create new liability for the company and lead to claims that the board members violated their fiduciary duties.

The general counsel should clearly delineate reporting lines for those investigations he oversees. He should quickly determine who he is reporting to – the president, CEO, board member, or other person. The general counsel should delineate how outside counsel reports to the company, discussing both the frequency and recipients of reports.

The company needs to speak with one voice in directing the investigation. Different managers within the company may have different agendas with regard to the internal investigation, viewing it as a threat or opportunity. Thus, the general counsel must control access to the outside counsel.

The frequency of outside counsel's reports to the general counsel depends upon the severity of the allegations. Outside counsel may report anywhere from several times a day to a couple times a month. Most of the reports should be oral. Regardless of how scrupulously a company fulfills the requirements of the attorney-client privilege, privileges are routinely discarded or breached as a result of pressure from prosecutors, waivers, bankruptcy trustees reversing management decisions, or inadvertent company disclosures.

Thus, when counsel is reporting on an ongoing investigation and the fact gathering and analysis are not complete, written and electronic reports should have only the most basic factual data, i.e., dates, times, names. One should not be making judgments on intent, guilt or other highly subjective areas before the investigation is complete.

What one person may consider a loose, imprecise e-mail routinely updating in-house counsel, could nonetheless have significant consequences if government investigators or class action counsel get their hands on it. At that point explanations that the author was being humorous, sloppy or misinformed will likely carry little weight.

Company employees

Some of the most difficult and sometimes distasteful decisions concern how a company treats employees who are part of the alleged misconduct. People with years of dedicated service may be facing tarnished reputations, formal discipline, termination, or imprisonment.

If the investigation is widely known in the company, management may want to issue a written statement informing the employees generally of the nature of the situation and how the company intends to respond to it.

Typically, if an employee has legal exposure and there is a likelihood that the government may want to talk with her, the company will recommend that she get her own lawyer. State law and company bylaws usually require that before the company pays for such counsel, the employee sign an undertaking, in which she states a willingness to reimburse the company for any legal fees that are advanced, if it is subsequently found that the employee acted contrary to the company's interests.

If the employee is facing a legal problem because she followed company policy or a supervisor's directions, there is a strong basis for providing legal representation.

Courts have recently criticized government attempts to pressure companies to stop paying for the legal defense of their employees. This underscores the recurring balancing act that companies face when they try to appeal to government discretion not to prosecute them, while at the same time fulfilling legal or ethical obligations to their employees. Over the next several months, there probably will be some guidance from the courts as to how far the government can pressure a company over advancing legal fees to employees.

Senior executives frequently look to a trusted general counsel to advise them on their personnel interests. A general counsel may need good political skills to keep senior management's confidence that he is not being disloyal to them while he is maintaining undivided loyalty to the "company." Thus, when senior executives are personally involved in the matter, quickly advising them to get their own counsel can deflect such pressures.

It is quite appropriate and standard for a company to enter into a joint defense agreement with many of its employees so that they can share information to help the internal investigation and to assist each other's legal representation. Though government prosecutors may scoff at JDAs because they believe they impede the prosecution's progress, the courts recognize JDAs as being entirely ethical and quite practical. Rarely can a company get the complete information necessary to conduct an effective internal investigation and have an honest dialogue with the government, if it does not give its employees the confidence that they can talk to their employer without having everything automatically turned over to the government.

Disclosures

If the matter is high profile or potentially material to the company's finances, general counsel and counsel conducting the internal investigation should discuss the issues with the company lawyers overseeing its SEC filings.

In addition to SEC filings, a company may have covenants to banks and other lenders, representations to investors and joint venturers, and other business relationships in which it needs to disclose potential legal problems. All of those obligations should be carefully reviewed when the investigation starts, to make sure that the company does not violate its obligations.

For example, some bank documents consider the borrower's representation that there are no known legal problems to be reaffirmed each time a company draws on a line of credit. Any such disclosures have to be carefully reviewed by legal counsel expert in that field (securities, banking) as well as the outside counsel conducting the internal investigation. There must be scrupulous accuracy in any descriptions provided to any outside entities, or a general counsel may find himself personally accused of misconduct.

If management is going to address such issues in an investor call, counsel should carefully script all comments, and everyone must stick to the script. Executives, concerned that the market may overreact to a problem, frequently give sincere assurances that make disclosure counsel cringe.

The media

An unfortunate corollary of high profile cases is that news of a prosecution frequently gets into the media before the matter is concluded. At the outset, a company needs to enlist an experienced crisis communications manager who knows how to deal with press coverage.

Though many companies have press advisors who know how to generate publicity, crisis communication managers are particularly adept in stopping or dampening fast-breaking stories. How to deal with the press may become a tug-of-war. Outside counsel handling the problem will correctly argue that any press statements may further complicate the problem. Will the SEC claim the company falsely assuaged the market? Will prosecutors treat candor as inculpatory admissions?

Yet, if a company remains silent during a multi-year investigation, it may suffer lost market share, employee defections, and lost opportunities. Some prosecutors have not been shy with their public releases, which can drive down share price and force a company to settle for reasons unrelated to the merits of the accusation.

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