'Outsourcing' Ruling, 5 Years On: A Warning, Not A Watershed

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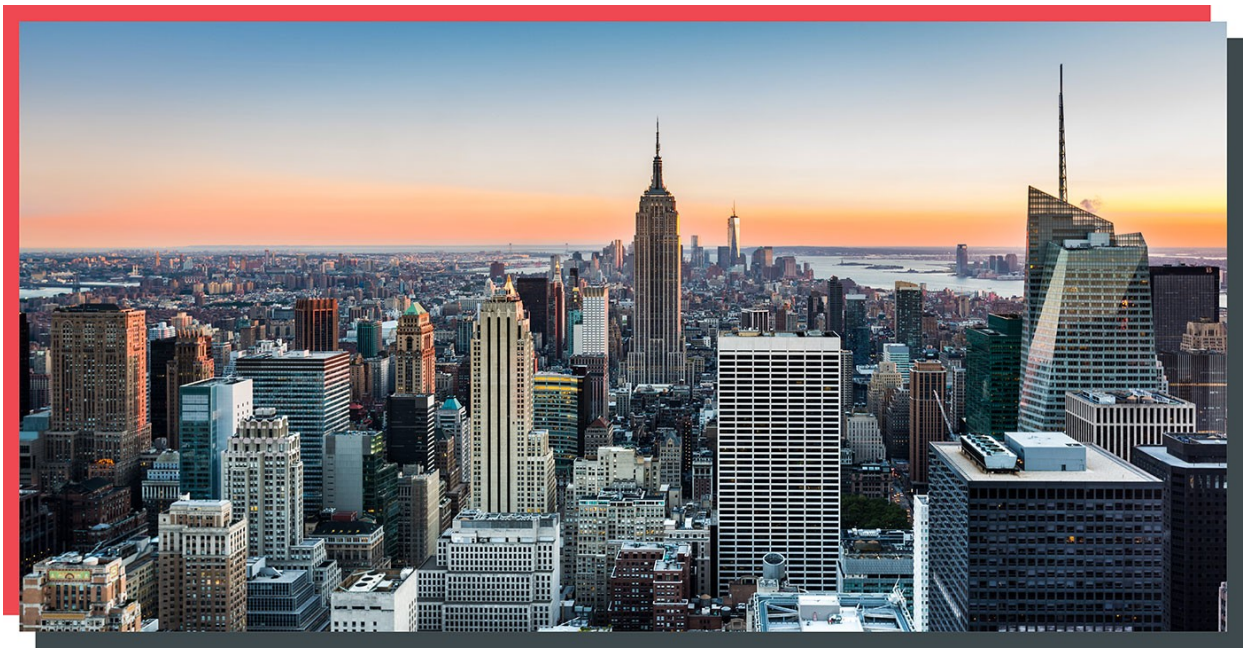

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In 2019, the U.S. District Court for the Southern District of New York issued a decision in *U.S. v. Connolly* with a noteworthy finding: The U.S. Department of Justice improperly outsourced its investigation to Deutsche Bank AG and its outside counsel.[1]

The court found that the DOJ's extensive involvement in the bank's purportedly internal investigation, along with the absence of any "independent investigative efforts" by the DOJ, amounted to the bank and its outside counsel being "de facto the Government."

Accordingly, the conduct of the bank and outside counsel, forcing a then-employee — who later became a defendant — to sit for internal interviews "under threat of termination, [was] fairly attributable to the government."

Thus, according to the court, the government improperly compelled these statements, meaning that the statements were involuntary and, therefore, inadmissible against the defendant during his criminal trial.

The ruling was widely circulated among the white collar bar, with many believing it would be a watershed decision that would firmly change the nature of corporate internal investigations conducted as part of broader efforts to cooperate with the government. The court even noted that it was "fully aware that this ruling may have implications that extend well beyond this particular case."

Five years later, predictions that Connolly would dramatically remold how internal investigations are handled appear to have been overblown. However, Connolly is not without lasting impact and remains an important warning, especially in an era marked by ever-increasing incentives for cooperation with government investigations.

The Case

Connolly stemmed from a 2010 Libor manipulation investigation started by the U.S. Commodity Futures Trading Commission against Deutsche Bank, and later joined by the U.S. Securities and Exchange Commission and the DOJ.

In the face of this scrutiny, the bank chose to cooperate by launching an internal investigation into the alleged misconduct. In pursuit of cooperation credit, the bank retained outside counsel; heeded the government's instructions; provided the government with updates; and interviewed individuals at the government's direction, including Gavin Black, who worked on the bank's money market and derivatives desk in London.

The bank's outside counsel interviewed Black on multiple occasions and, as is par for the course in an internal investigation of this sort, Black had to either submit to the interview or face termination.

Throughout the investigation, the bank and its counsel continued to update the government about their findings and coordinate next steps as to Black and other bank employees. During these meetings, the government gave the bank and outside counsel directives on how the internal investigation should proceed.

When the investigation concluded, the bank's counsel submitted a report to the government, summarizing the findings of its Libor investigation and laying out a road map of the case against various bank employees.

Throughout the investigation, the bank's counsel interacted with the government on hundreds of occasions, including "some 230 phone calls and 30 in-person meetings," culminating in weekly update calls for the final 14 months of the investigation. The bank went far beyond the mere transfer of information to the government, and instead worked closely with the government.

After a five-year internal investigation, the bank entered into a deferred prosecution agreement with the DOJ. The DOJ criminally prosecuted Black and Matthew Connolly, who supervised bank traders of USD Libor-based derivative products.

When it came time for trial, Black argued that the government could not use his statements, which the bank had collected, against him without violating his Fifth Amendment privilege against self-incrimination. Even though the government did not use his statements in his prosecution, Black was ultimately convicted.

Black then challenged his conviction, explaining that the bank's close investigatory relationship with the government, coupled with the fact that Black was forced to submit to questioning to avoid losing his job, amounted to compulsion imputable to the government in violation of the Fifth Amendment.

Black further argued that the entire prosecution against him was "infected by" the statements he made under compulsion, even though the statements themselves were not introduced.

The court agreed, in part, holding that Black's interview was compelled and attributable to the government due to the government's direction of the bank throughout the investigation.[2]

However, the court found that the statements did not infect the prosecution under the U.S. Supreme Court's 1972 decision in U.S. v. Kastigar,[3] which prohibits the use of a defendant's compelled statement.

The decision raised questions about the very nature of cooperation in government investigations. Scholars and practitioners alike wondered if Connolly represented the first in a line of cases that would undermine the ability of companies to cooperate with the government while conducting internal investigations. Many feared that Connolly would significantly undercut cooperation incentives in the future.

Recent Developments

Now, five years after the decision, it seems that these fears were, in large part, unfounded. Indeed, the few courts that have confronted the same issue have not adopted an expansive interpretation of Connolly.

For example, in U.S. v. Hwa,[4] the U.S. District Court for the Eastern District of New York in 2021 rejected the defendant's request to deem Goldman Sachs Group Inc. to be "part of the prosecution team" because the firm cooperated with the DOJ and entered into a deferred prosecution agreement. Such a designation would have triggered discovery obligations, including under Rule 16 of the Federal Rules of Criminal Procedure.

In Hwa, the DOJ argued that (1) "as a cooperating private party, the Goldman Sachs Group [was] not part of the prosecution team," and (2) "documents in the Goldman Sachs Group's possession [were] not within the Government's 'control' for the purposes of Rule 16."

The court distinguished this case from Connolly, noting that Connolly did not consider whether the bank was engaged in a joint investigation with the government that amounted to the bank being part of the prosecution team, but instead "whether a particular action ... could be attributed to the Government as state action."

On the latter, the court noted that, unlike Connolly, the government in the Hwa case "took significant independent investigative steps beyond seeking information from the Goldman Sachs Group."

As another example, in 2021, the U.S. District Court for the Eastern District of Wisconsin also distinguished U.S. v. Armbruster[5] from Connolly, noting that the potential consequences of not cooperating with an interview request amid an internal investigation into securities and wire fraud, at a freight service company called Roadrunner Transportation Systems, "were non-specific and speculative" because the employee did not face certain termination for noncompliance.[6]

Therefore, the court reasoned, the self-incriminating statements made during the investigation were not compelled and could not violate the Supreme Court's 1967 decision in U.S. v. Garrity.

The relevant employee handbook stated, "Failure to fully participate in an internal investigation will result in discipline up to and including termination."

Beyond failing to spark an explosive progeny of cases, Connolly was followed by an era where cooperation incentives have only increased for companies and individuals alike.

For example, in September 2020, the SEC expanded its whistleblower program, introducing a presumption of a maximum statutory award amount in cases under $5 million and offering increased protections to whistleblowers.[7]

Further, in March 2023, the DOJ's Criminal Division launched the pilot program on compensation incentives and clawbacks, which provides that companies that successfully recoup compensation from culpable employees may obtain a fine reduction in an amount equal to successfully clawed-back compensation.[8]

The program also permits a fine reduction of up to 25% when a company attempts to claw back compensation from culpable employees in good faith but is ultimately unsuccessful.

Next, in July 2023, a bipartisan group of legislators introduced the CFTC Whistleblower Fund Improvement Act to address a funding crisis undermining the CFTC's whistleblower award program.[9] The bill, which is in committee, would raise the cap on the funds used to pay awards and help ensure the continued success of the program.

The DOJ continued to expand on its efforts in October 2023, when it announced a voluntary self-disclosure policy concerning mergers and acquisitions, which incentivizes acquiring companies to promptly report uncovered misconduct by the acquired company.[10]

2023 also marked a record-breaking year for both the SEC's and CFTC's whistleblower programs.[11]

And 2024 has already seen an even further increase in whistleblower protections. In January, the U.S. Attorney's Office for the Southern District of New York announced a new whistleblower pilot program for individuals that allows for nonprosecution agreements in exchange for early, actionable self-disclosure concerning "criminal conduct undertaken by or through public or private companies, exchanges, financial institutions, investment advisers, or investment funds involving fraud or corporate control failures or affecting market integrity."[12] This program includes no financial incentives.

Finally, in March, the DOJ announced a departmentwide award-based whistleblower program for corporate whistleblowers, which is aimed at filling the gaps in incentives to self-report corporate misconduct.[13]

Looking Forward

The growing trend of cooperation initiatives in the corporate compliance space may tempt corporations to disregard the warning of Connolly in its entirety. After all, the proverbial carrot encouraging cooperation with the government has never been larger.

We caution, however, that ignoring Connolly completely would be a mistake. Connolly may not be a watershed, but it is still a warning.

A decision that remains good law to this day, Connolly imputes to the government conduct occurring in a private company's internal investigation, provided that the government has a prominent role in directing the investigation. Such control may convert a typical internal interview into a government-compelled interrogation in violation of the Fifth Amendment.

What does this mean for a company conducting an internal investigation? It means that companies must not lose sight of the fact that an internal investigation is, in the first instance, a company's own fact-finding mission.

Consequently, we advise that cooperation and the associated incentives should be evaluated after evidence is uncovered, rather than vice versa.

Summarily, while the decision for a company to self-report and cooperate may be wise, it should also be accompanied by a clear plan and proper procedures, which include:

- Making a clear record concerning the company's reasons for conducting the internal investigation;
- Documenting any reasons underlying the decision to cooperate, which should be made (1) after evidence of misconduct is uncovered and not vice versa, and (2) in light of the benefits to the company's stakeholders;
- Maintaining an independent internal investigation after any decision to cooperate — though the company should remain attentive to the government's requests, it should also make independent determinations as to how the investigations proceed, including how and when interviews are conducted;
- Issuing proper Upjohn[14] warnings and maintaining clear, written policies concerning the consequences of noncompliance with internal investigations; and
- Avoiding framing the company's prior investigatory actions as having been done purely at the government's behest when advocating to the government concerning the scope and value of the company's cooperation after the investigation has concluded.

After Connolly, the core of internal investigations and, if justified, corporate self-reporting to the government remains fundamentally unchanged. Now, more than ever, such cooperation involves robust and thoughtful engagement with the government.

Connolly does not change that, and instead is a reminder that these investigations and cooperation efforts, while influenced by the government, must nonetheless ultimately be self-directed.

[1] See United States v. Connolly , 2019 WL 2120523 (S.D.N.Y.).

[2] See United States v. Garrity , 385 U.S. 493, 496-497 (1967) (holding statements obtained from police officers under threat of termination of employment were involuntary and therefore inadmissible against them in a criminal trial); see also United. v. Stein , 541 F.3d 130, 152 n.11 (2d Cir. 2008) (extending Garrity to private conduct where the actions of a private employer are "fairly attributable to the government").

[3] United States v. Kastigar , 406 U.S. 441, 453 (1972).

[4] United States v. Hwa , 2021 WL 11723583 (E.D.N.Y.).

[5] United States v. Armbruster , 2021 WL 2351959 (E.D. Wis.).

[6] United States v. Naggs , 2020 WL 10458572 (E.D. Wis.), report and recommendation adopted sub nom. United States v. Armbruster , 2021 WL 2351959 (E.D. Wis.).

[7] https://www.sec.gov/newsroom/press-releases/2020-219.

[8] https://www.justice.gov/criminal/criminal-fraud/file/1571941/dl.

[9] https://www.congress.gov/bill/118th-congress/senate-bill/2500/text.

[10] https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-announces-new-safe-harbor-policy-voluntary-self.

[11] https://whistleblowersblog.org/corporate-whistleblowers/sec-whistleblowers/sec-whistleblower-program-had-a-record-setting-2023-fiscal-year/; https://www.whistleblowerllc.com/cftc-reports-record-breaking-numbers-in-fiscal-year-2023/.

[12] https://www.whistleblowerllc.com/cftc-reports-record-breaking-numbers-in-fiscal-year-2023/.

[13] https://www.selendygay.com/news/publications/2024-03-12-doj-announces-financial-incentives-program-for-corporate-whistleblowers.

[14] Upjohn Co. v. United States , 449 U.S. 383 (1981).

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