SOX Litigation-Hold Triggers – Public and Private Companies Susceptible to Criminal Prosecution for Obstruction of Justice

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BY ROBERT D. BROWNSTONE,* CATHERINE KEVANE** AND J. CARLOS ORELLANA***

FENWICK & WEST LLP

The Rock and the Hard Place

Years after passage of the Sarbanes-Oxley Act of 2002, many companies still believe the Act applies uniquely to public companies. In fact, private companies that ignore the Act's obstruction-of-justice provisions do so at their peril. Two increasingly important provisions of Sarbanes-Oxley were set forth in §§ 802 and 1102 and codified, respectively, at 18 U.S.C. § 1519 and 18 U.S.C. § 1512(c). These provisions impose substantial criminal penalties on any individual or entity – public or private – for destruction of evidence or obstruction of justice regarding any actual or "contemplated" federal investigation, matter or official proceeding. A company therefore potentially could violate the law before an actual official governmental interest arises.

Thus, it is critical for every entity to ensure that its records-retention policy includes appropriate triggers – called "litigation holds"–to suspend the routine deletion of information for situations contemplated by §§ 802 and 1102. There is, however, an elephant in the room–a "compliance gap" challenge that is of particular concern not only to quasi-governmental organizations but also to companies in heavily regulated industries facing routine government scrutiny. Those companies could find that an overbroad policy theoretically encompasses nearly all of their day-to-day work. Accordingly, those companies, even more than most, must balance the need for a practical records-retention policy with the need to comply with Sarbanes-Oxley's mandates.

This compliance conundrum evokes Scylla and Charybdis from Homer's Odyssey. The late rocker Warren Zevon channeled Homer in his song, "Lawyers, Guns and Money": "I'm the innocent bystander, and somehow I got stuck between a rock and a hard place, and I'm down on my luck." The rock/hard place challenge of Sarbanes-Oxley compliance is the tension entailed in setting retention language that is broad enough to include a reasonably anticipated government interest, proceeding or regulatory inquiry contemplated by Sarbanes-Oxley, but not so broad that, when viewed in hindsight by a judge, even routine governmental oversight is deemed to have necessitated a litigation hold.

Neither the statutory language nor the scant case law provides much guidance on when a company must impose a litigation hold under §§ 802 and 1102. However, several principles may help any company devise a retention regime not only cognizant of business realities but also compliant with the Act's obligations.

Lest We Forget Enron

Sections 802 and 1102 were enacted, in part, in response to Arthur Andersen's shredding of documents during the government's investigation into Enron Corp. *Arthur Andersen LLP v. U.S.*, 544 U.S. 696 (2005) ("jury instructions... failed to convey the requisite consciousness of wrongdoing"). Cf. *U.S. v. Quattrone*, 441 F.3d 153 (2d Cir. 2006) (jury not told of defendant's lack of knowledge of investigation's specific focus). In both Andersen and Quattrone, a conviction for inciting destruction was overturned based on a jury instruction's omission of the appropriate *mens rea*.

Post-Sarbanes-Oxley, however, federal prosecutors have more arrows in their obstruction/tampering quivers. Mirroring the Act's concerns, the Dec. 1, 2006, amendments to the Federal Rules of Civil Procedure focus on retention and production of electronically stored information. In addition, courts, government regulators, public auditors and the plaintiffs' bar are becoming increasingly sophisticated as to electronic discovery issues such as metadata, keyword searching and forensic imaging. In turn, the demands have intensified for greater transparency in companies" policies and practices.

A well-crafted policy–with which a company substantially complies and enforces as uniformly as possible–can protect against allegations of improper spoliation. However, an overbroad and/or haphazardly applied policy can have the opposite effect. For example, a gap between the general protocol and the specific actions taken can become grist for a litigation adversary or prosecutor to undermine–or even obtain judicial invalidation of–the preservation steps taken. Policies must be sufficiently narrow so that companies can, as a practical matter, comply, but broad enough to satisfy the legal requirements of §§ 802 and 1102.

What Do Sections 802 and 1102 Require?

Section 802 provides:

> Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

18 U.S.C. § 1519.

Its counterpart, § 1102, provides the same potential punishments for:

> [w]hoever corruptly – 1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or (2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so.

18 U.S.C. § 1512(c).

Most broadly read, those statutes require the individual or entity to act "knowingly" or "corruptly" and with intent to "impair," "impede, obstruct or influence" a matter within the jurisdiction of the government or "in relation to or contemplation of any such matter." The precise contours of the *mens rea* requirements are still undefined. No published decisions have interpreted § 1102's *mens rea* requirements, and cases interpreting § 802 are scarce. The existing case law has focused on two key issues: What constitutes an "investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States," and what conduct is "in relation to or contemplation of any such matter or case"?

In *U.S. v. Ionia Management S.A.*, No. 3:07 CR 134, 2007 U.S. Dist. Lexis 91203 (D. Conn. Dec. 12, 2007), the defendant company was convicted under § 802 of falsifying records it was required to maintain and provide to the U.S. Coast Guard pursuant to a previous probation order. The defendant filed a motion for judgment of acquittal or, alternatively, a new trial. In its motion, the defendant argued that the Coast Guard's supervision of the defendant's probation was not part of the administration of the Coast Guard's jurisdiction but rather a function of the judicial branch and thus did not fall under § 802. Id. at *17. The court disagreed, finding the pertinent activities were under the Coast Guard's jurisdiction and consequently "within the extremely broad coverage of [§ 802]." Id. at *27-*28.

In *U.S. v. Fumo*, No. Crim. A. 06-319, 2007 U.S. Dist. Lexis 79454 (E.D. Pa. Oct. 26, 2007), the defendants moved to dismiss the § 802 charges by challenging the statute's "in contemplation" language as unconstitutionally vague. The court ruled that § 802 was not unconstitutionally vague as applied to the primary defendant because the indictment had alleged his destruction of electronic evidence after learning of a government investigation. Id. at * 63-*65.

Government's Actual interest

In both Ionia and Fumo, the defendants were allegedly aware that the government had an actual – as opposed to potential – interest in the pertinent records. A thornier question arises when no investigation or exercise of administrative authority has begun, or the defendant is unaware of either such type of activity. As Ionia noted, "In comparison to other obstruction statutes, [§ 802] by its terms does not require the defendant to be aware of a federal proceeding or even that a proceeding be pending." 2007 U.S. Dist. Lexis 91203, at *25.

Indeed, at least one federal prosecutor has filed an indictment based on §§ 802 and 1102 when the defendant was not even alleged to have known of a pending governmental investigation. See *U.S. v. Russell*, No. 3:07-cr-00031-AHN-1 (D. Conn. 2007), available by searching on case number at ‹https://ecf.ctd.uscourts.gov/cgi-bin/DktRpt.pl›. The Russell indictment alleged that the defendant, an attorney, had destroyed a laptop computer allegedly containing child pornography downloaded by a former employee of the defendant's client, a church. As noted in the defendant's motion to dismiss, the indictment

did not allege the defendant's knowledge of any investigation into the former employee's conduct. A superseding indictment was issued, apparently to address the defendant's argument that there had been a fatal failure to "allege any nexus between the defendant's conduct and any federal proceeding which was reasonably foreseeable." However, because the defendant pleaded guilty to a lesser offense, the charges" sufficiency was not thoroughly tested.

Towards a SOX-compliant Records-Retention Policy

To establish when preservation is required, a policy should, at minimum, list the Sarbanes-Oxley-mandated triggers in its litigation-hold section or in a separate litigation-hold protocol. Under current interpretations of §§ 802 and 1102, a hold is mandatory whenever any federal department or agency may assert jurisdiction over a particular matter.

For example, each of the following situations would ostensibly warrant imposition of a litigation hold under the statutes:

- Commencement of an internal investigation of possible violations of the Foreign Corrupt Practices Act, implying the likely intervention of the U.S. Department of Justice.
- Agreeing to a corporate acquisition likely to trigger a Federal Trade Commission Hart-Scott-Rodino review.
- An employment discrimination accusation subject to Equal Employment Opportunity Commission jurisdiction. (In the civil setting, two decisions have held that litigation is reasonably anticipated once a (former) employee takes the tangible step of filing an EEOC charge. *Broccoli v. EchoStar Commcn's*, 229 F.R.D. 506 (D. Md. 2005) ; *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212 (S.D.N.Y. 2003) (*Zubulake IV*).)

However, the drafter of a Sarbanes-Oxley-compliant records-retention policy should take care not to create a compliance gap by imposing unachievable or impractical standards. Rather, the policy should impose a litigation hold when a legal proceeding or an assertion of governmental authority is "known or reasonably anticipated" or "known or reasonably foreseeable." Depending on the industry, level of governmental regulation and history of government inquiries and proceedings, the drafter may be able to anticipate when such an assertion of authority is reasonably likely.

The policy should assign litigation-hold issuance decision-making to a specific person – preferably in-house counsel – or a very small group. Such a pre-specified process will aid in establishing the good-faith execution of a valid policy.

A legally defensible policy also should provide for:

- Prompt identification of custodians likely to have pertinent information.
- An assessment of the format(s) and location(s) in which each relevant custodian maintains that information.
- An appropriate preservation process ensuring the maintenance of the information as it existed when the hold issued.
- Guidance on the length of the preservation. (Absent an explicit statutory or regulatory directive, a general benchmark can be the relevant statute of limitations.)

Substantial Compliance

In today's sophisticated, contentious preservation landscape, it is crucial for public and private companies to implement and abide by well-crafted retention policies and procedures. In light of the breadth and ambiguity of §§ 802 and 1102, drafting a legally defensible and practical policy is a challenging first step. The second and equally critical next step is substantial compliance, achieved in part by adequately educating employees and revising the policy over time so that it continues to evolve with the company.

A company should revisit its retention policy – including its list of litigation-hold triggers – annually, taking into account new internal and external factors. Examples of internal changed circumstances are new corporate ventures, geographical expansion and additional product lines. External considerations may include areas of novel or increased government enforcement or scrutiny. Unfortunately, the courts have not yet fully articulated the parameters of §§ 802 and 1102. Until they do, hold determinations are sometimes made in a black box, with the company left to speculate whether a government interest will arise.

Although perfection is not required, the courts will critically evaluate record-retention policies and the application of those policies. See *Andersen*, 544 U.S. at 704. Scattershot destruction of records or the lack of an implemented, real retention regime can be quite problematic. Similarly, even absent bad-faith conduct, a preservation/destruction time line constructed and examined after the fact may not pass the smell test. Conversely, establishing thoughtful, well-documented and ever-evolving policies and protocols can go a long way toward insulating a company from retroactive scrutiny or, even worse, criminal prosecution.

*Robert D. Brownstone *is the Law and Technology Director at Fenwick & West. He advises clients on electronic discovery, on electronic information management and on retention/destruction policies and protocols. Robert also collaborates with clients as to computer solutions enabling compliance with legal obligations. He is a member of four state bars (including California and New York) and of the Information Systems Auditing and Control Association (ISACA). Robert can be reached at rbrownstone@fenwick.com or 650-335-7912.*

***Catherine Kevane *is an Associate in the Litigation, Securities Litigation and Electronic Information Management Groups at Fenwick & West LLP. Her practice focuses on defending shareholder class actions and derivative litigation throughout the country. Catherine also represents companies and individuals in investigations brought by the Securities and Exchange Commission and Department of Justice. She can be reached at ckevane@fenwick.com or 415-875-2392.*

****J. Carlos Orellana*

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For further information, please contact one of the authors or any of these Fenwick & West Litigation Partners:

Michael A. Sands, Chair, Electronic Information Management Group
msands@fenwick.com, 650-335-7279

Emmett C. Stanton, Co-Chair, Securities Litigation Group
estanton@fenwick.com, 650-335-7175

Kevin P. Muck, Co-Chair, Securities Litigation Group
kmuck@fenwick.com, 415-875-2384

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