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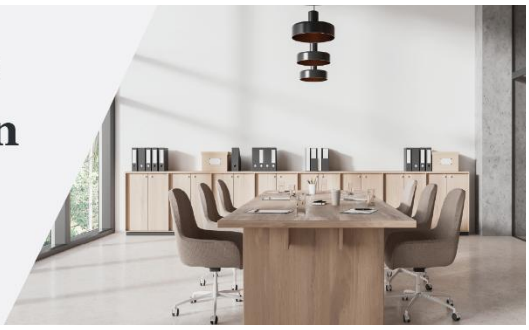
The Role of External Counsel in Misconduct Investigations: Perspectives on Treating Corporations as a Client



1. Practical Perspectives on Corporate Investigations Involving Conflicting Interests

In recent years, growing attention to media reports and regulatory responses concerning corporate misconduct has led to increased discussion of internal and third-party investigations.

The importance of misconduct investigations is not, in itself, a recent development. Corporate misconduct has long existed, and corporations have always faced the need to determine whether misconduct has occurred, identify its causes, and consider what measures should be taken in response.

What appears to have changed in recent years is, rather, the level of accountability expected of corporations after misconduct is uncovered, the transparency of investigations, and the degree of internal and external scrutiny directed at the investigation process itself.

In practice, investigations into corporate misconduct are not necessarily conducted solely for the purpose of establishing the relevant facts. Multiple interests and organizational tensions may exist surrounding the alleged misconduct, in addition to the event itself. In particular, these include, matters involving officers or senior management, differences in perception between the headquarters and the Japanese subsidiary of a cross-border corporations, and dissatisfaction with management policies or organizational management existing in the background. As a result, organizational conflicts of interest may surface during the course of an investigation, and the findings of the investigation may have significant implications in the decision making process.

However, even in such cases, an attorney involved in an external investigation should not advocate for the interests of particular members of management, whistleblower, or internal department, but rather recognize “the corporation itself” as the client and conducting the required investigation, analysis, and advice to enable the corporation to make appropriate decisions and continue its business operations.

2. What does “Treating the Corporation as the Client” Mean?

In misconduct investigations, the question of “whose interests the investigation is intended to serve” can often become blurred in practice.

This is particularly the case where an investigation is prompted by conflicts among officers, whistleblower reports, human resources issues, or concerns raised by an overseas headquarters, as the various parties involved may have different expectations of the investigation.

For example, one party may expect the investigation to focus on the responsibility of a particular individual, another may seek an early resolution of the matter, while another may place greater emphasis on minimizing the risks associated with external communications.

However, the main purpose of an investigation conducted by external counsel is not to reconcile these individual interests.

In practice, of course, it is inevitable that the findings of an investigation will affect human resources matters, governance, responses to regulatory authorities, shareholder relations, and other matters. At a minimum, however, the investigation itself should not be undertaken with a predetermined conclusion in mind. Rather than short-term organizational self-protection (concealment or downplaying), unless the underlying problems are brought fully to the surface and resolved, the long-term survival of the corporation itself may be endangered. Investigations should be a process of setting out what risks exist for the corporation and what responses are reasonable, in light of the confirmed facts, evidence, results of interviews, and applicable laws and regulations. A reasonable analysis also supports the corporation's accountability and the continuity of its business, it accords with the interests of the corporation over the long term.

In this sense, the perspective of “treating the corporation as the client” is not merely an abstract proposition. It has significant practical implications at each stage of the process, which includes scoping the investigation, designing interviews, preserving materials, reporting the findings, and advising management.

3. The Significance of Distinguishing “Illegality” from “Business Judgment” in the Investigation Process

One of the difficult issues in a misconduct investigation is determining the appropriate scope of the investigation, and from what point matters should be treated as legal or compliance issues, or in the area of business judgment.

In the course of corporate activities, investment decisions that ultimately proved unsuccessful, overly optimistic business plans, reliance on particular business partners, decisions taken without adequate explanation, and similar matters may later be called into question.

However, the fact that a loss ultimately occurred does not by itself mean that the underlying conduct should be regarded as unlawful.

As the business judgment rule is recognized, within certain limits, under Japanese law, it is important in an investigation to also maintain the perspective of distinguishing between “decisions that proved unwise with the benefit of hindsight” and “conduct capable of constituting a legal issue, such as a breach of the duty of due care or aggravated breach of trust.”

In practice, external investigations generally do not delve into the abstract question of whether something was appropriate from a management standpoint. Instead, they typically examine whether legal or compliance issues exist by considering whether material facts were concealed, false explanations were given, conflicts of interest arose, internal approval procedures were circumvented, private benefits were conferred and applicable laws or material internal rules were violated. Where internal approval procedures forming the basis of a business judgment were intentionally circumvented, or where audit or oversight functions (governance) did not operate adequately, whether there was a breach of the duty of due care by the relevant officers will naturally be subject to close scrutiny.

This is not intended to improperly narrow the scope of an investigation. External investigations are not intended to replace a corporation’s management decisions with external counsel’s judgment, nor are they meant to contribute to the kind of hindsight-based accountability that is often exploited in internal conflicts of interest. They provide an important perspective for clarifying the role of providing legal and compliance-related information to assist the corporation in making appropriate decisions.

4. The Role of External Investigations Amid Conflicts of Interest

In practice, it is not straightforward to consistently maintain the position of "treating the corporation as the client."

This is particularly true in matters involving serious misconduct. Whistleblowers, management, relevant departments, overseas headquarters, and other stakeholders often have strong concerns or emotions not only regarding the underlying issues but also regarding how the matter should ultimately be resolved. As a result, the investigation team may face explicit or implicit pressure to move the investigation in a particular direction.

It is precisely in such circumstances that an external investigation must avoid aligning itself with any particular position and instead assess the risks facing the corporation on the basis of the established facts, the evidence collected, and the applicable legal analysis. The moment the investigation becomes an instrument to advance the interests of a party other than the corporation, confidence in the external investigation process is compromised.

It is also important to recognize that external investigations are not conducted to provide the "correct answer" from a management perspective. The merits of a particular business decision or management strategy are, in principle, matters of managerial responsibility for the corporation. The role of the investigation team is to identify and assess potential violations of laws and regulations, breaches of the duty of due care, conflicts of interest, the aggravated breach of trust, and other serious compliance risks, and to provide the corporation with the information it needs to decide an appropriate response and course of action.

In this sense, an external investigation is neither a mechanism for protecting one party nor for removing another party. The role expected of an attorney conducting such investigations is to report the facts as they are from the perspective of the corporation's long-term interests, rather than from the perspective of short-term organizational self-preservation or internal power dynamics, even where the findings may at times be unwelcome to the current management.

5. Conclusion

Misconduct investigations are often understood as a "process for uncovering misconduct." However, their essential purpose is not to determine whether misconduct has occurred. Rather, it is to identify and assess the facts and legal risks and to provide the corporation with the information it needs to make appropriate decisions necessary for the corporation to continue operating and carrying on its business on a sound basis.

For this reason, an attorney engaged in external investigations must act on the basis that the corporation is the client, without allowing the interests of particular members of management, whistleblowers, or internal departments to influence their work. Maintaining this position consistently is not easy where competing interests are sharply opposed. Even so, acting on the basis that the corporation is the client is perhaps the single most important role required of external professionals engaged in misconduct investigations.

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