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Corporate Monitors: Make the Most of the Appointment

By Eleanor Tyler, Senior Legal Editor, Bloomberg Law

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Volkswagen's plea agreement with the Justice Department, like many such settlement agreements involving major corporate fraud, includes a provision appointing an independent monitor to make sure the automaker keeps its contractual end of the bargain.

The DOJ often requires a corporate monitor at an offending corporation for one to three years, but there is little solid information about how monitors are selected and operate or what companies should expect during the monitorship.

Seasoned monitors say that some of the confusion stems from the nature of the job: there is no model for how monitorships work because corporations are different and crimes are different. The parties to a settlement need flexibility and confidentiality in crafting a monitorship that will work optimally for both sides.

However, that means that most corporations come into the relationship with no idea what to expect—and significant misconceptions about the role of the monitor and how to best benefit from his or her services.

"Monitorship shouldn't be seen as punishment: The end result ought to be a benefit to the company," said Bart M. Schwartz, a monitor with more than 30 years' experience in the job. Schwartz and other experienced monitors outlined what corporations can do to achieve that benefit, and what to expect going in.

Who Is a Monitor?

Monitors have become an increasingly common judicial and regulatory tool.

A monitor is an independent third party appointed by a court or by agreement with a regulatory agency to verify that a corporation is keeping its promises under settlements or court orders. The basic mandate is typically to assess and monitor corporate compliance and ethics in order to reduce the risk a company will repeat misconduct.

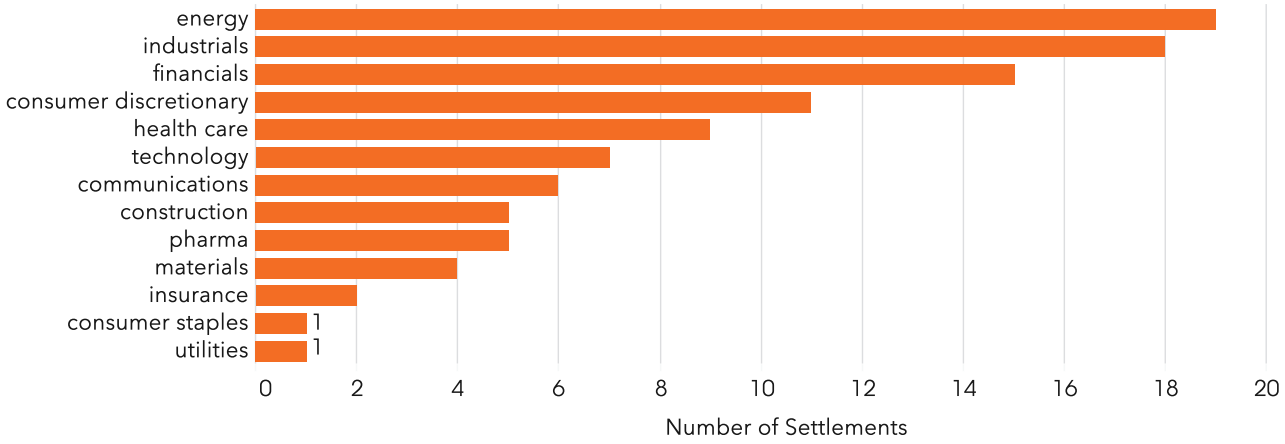
Monitors are appointed by contract. While the contractual circumstances are often unpleasant for the company, appointing a monitor is largely a voluntary process. The DOJ's guidelines recognize that the purpose of appointing a monitor is not punitive, and the Justice Department generally permits the corporation to have a say in who is chosen. The corporation pays for the monitor, who reports to the enforcer at specified intervals on the corporation's compliance progress.

The Justice Department enters several different voluntary pre-trial agreements with corporations accused of federal criminal violations: non-prosecution agreements (NPAs), deferred prosecution agreements (DPAs) and plea agreements. Any of the three may contain a monitor provision.

The DOJ first used NPAs and DPAs in 1992, with the first monitorship following in 1995 in connection with Consolidated Edison's sentencing for failures surrounding a deadly steam pipe explosion.

NPAs and DPAs are now an important tool for the DOJ in prosecuting corporate crime. The Fraud Section of the Justice Department's Criminal Division charged 300 individuals, convicted 201, concluded 15 corporate resolutions and recovered $1.51 billion in corporate criminal fines and forfeiture

DOJ Criminal Div. NPAs and DPAs by Industry 2003–2017



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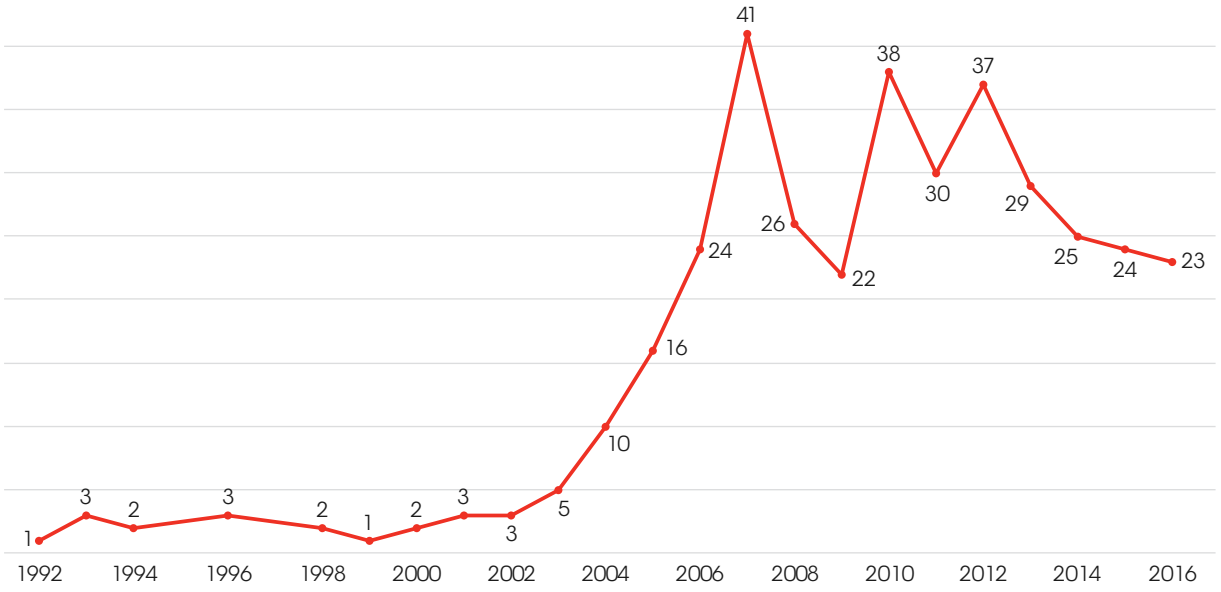
Data from Brandon L. Garrett and Jon Ashley, Federal Organizational Prosecution Agreements, University of Virginia School of Law, at http://lib.law.virginia.edu/Garrett/prosecution_agreements/home.suphp, and the Int'l. Assoc. of Indep. Corp. Monitors, http://iaicm.org/resources.

History of DOJ Criminal Div. Use of NPAs and DPAs for Corporate Crimes 1992–2016



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in the U.S. during 2016, according to the section's "year in review." Those numbers do not include several investigations that led to resolutions concluded in early 2017, including the Volkswagen plea agreement, or additional resolutions by U.S. Attorneys General in other offices.

Last year's numbers are roughly in line with the section's performance in 2015, continuing an upward trend in the use of DPAs and NPAs that began after 2000. DOJ divisions had entered a total of 108 NPAs and DPAs as of September 2009, according to a Government Accountability Office report from that year. The DOJ entered almost 300 more such agreements through mid-2016, according to Gibson Dunn & Crutcher LLP.

The increase in prosecutions, and attendant sharp increase in fines collected at the federal level, dates back to Enron, according to University of Virginia law professor Brandon L. Garrett. Garrett found that fines in general are going up but he cautioned against looking at fines in the aggregate. For example, a large spike in overall fines in 2009 is due almost entirely to a then-record $1.2 billion Pfizer Inc. paid for illegal marketing of its painkiller, Bextra.

But there is an increase in guilty pleas compared to NPAs and DPAs in recent years, he said. Shifts in policy at the DOJ cause changes in the trendline for each type of settlement and the type of punishment prosecutors seek for corporate crimes.

About 25 percent of NPAs and DPAs appoint a monitor, Garrett found. They are more common in specific types of crimes, including a spate of tax cases, Foreign Corrupt Practices Act cases and money laundering. Overall, however, the trend in monitoring over the past decade is upward.

DOJ Practice

The DOJ fraud section uses fairly uniform procedures, guidelines and forms in entering its criminal settlement agreements, including those that appoint a monitor.

Under the DOJ's guidelines for monitorships, the so-called Morford Memo, the fraud section typically allows the defendant corporation to nominate three possible monitors and the government picks one of them. A typical provision in a DPA provides that "the Company will propose to the Offices a pool of three qualified candidates to serve as the Monitor," but specifies that the fraud section can reject all three if it is not satisfied that the candidates are qualified. The agreement goes on to detail minimum qualifications for the monitor, which almost always include "demonstrated expertise" in criminal fraud law and corporate compliance and ethics but often also includes expertise in the specific industry.

The monitor's role in DOJ agreements is to ensure that the company not only meets the terms of its settlement agreement, but improves and enhances its compliance and ethics going forward. The broad outlines of the mandate are in the settlement agreement.

Typical contracts include the term of the monitorship and provide internal deadlines for deliverables, provide for how the monitor will be chosen and funded, provide the duties and responsibilities of the monitor and specify how the parties and the monitor will treat privilege issues. Most all agreements also set out that bills will be secret and that reports from the monitor to the enforcer will remain confidential. Agreements also provide for extending the monitorship if needed or early termination of the relationship if warranted. The agreement also typically provides for dispute resolution if the corporation and the monitor disagree about the appointment.

It is critical to the success of the appointment, however, that the monitor exercise independent judgment about what should be done to fulfill his or her contractual mandate. Independence is the most important and, according to monitors, sometimes the most difficult aspect of the job.

Practically speaking, the monitor and the corporation will usually hammer out a work plan that further outlines the appointment. Because

those specifications are not part of the contract with the DOJ, they do not restrain the monitor to the same extent.

Bang for the Buck?

For a number of reasons, it is difficult to assess how successful monitorships are in reducing future violations.

Corporate recidivism too broadly defined and taken alone is not necessarily an accurate measurement of whether a monitorship was effective — a single employee can get a corporation into serious criminal trouble, and a large, complex organization might continue to be susceptible to *other* violations. Where a corporation does reoffend after employing a monitor, however, veteran monitor John Hanson said that the fault sometimes lies in an overly narrow mandate. Many agencies are sensitive to overreach or creeping mandate — because they are spending the corporation's money in setting the monitorship's parameters, they can tend towards a conservative scope.

But some agreements don't wind up giving the monitor enough latitude and power to go after the underlying culture that set the stage for the violation, he said. While many agreements emphasize compliance, an enforcer "is missing the ball if it fails to look at ethics in addition to compliance."

In terms of numbers, clear repeat offenders stand out both because they are rare and for the size of their fines. Pfizer's record fine in 2009, mentioned above, was its fourth marketing violation since 2002. Deutsche Bank AG recently agreed to pay $425 million for money laundering to the New York Department of Financial Services. Deutsche Bank already had two monitors in place when it entered that consent agreement. The latest agreement calls for two years of monitoring, either through a new appointment or extending and broadening the mandate of one of the current monitors.

While metrics for success are hard to come by, agencies are obviously satisfied that monitors are a useful tool: They are not only increasingly imposed at the federal level, but their use is spreading among other enforcers. "Many more lower profile agencies are using monitors to ensure that consent decrees or other representations are being met," Schwartz said.

Costs are equally difficult to quantify. The corporation pays for the monitor, but fees vary widely based on length of the monitorship, the complexity of the business and settlement agreement, the state of the company's existing compliance and ethics program and the company's location and industries. Because bills from the monitor are confidential, and fees for individuals or teams working for the monitor differ, it is impossible to generalize about costs of the appointment.

More Transparency?

Although good information on the success of monitorships is hard to come by, the DOJ fraud section initiated a one-year pilot program for FCPA cases in 2016, which may lead to better metrics for many aspects of the settlement process.

The program is designed "to provide more transparency and consistency for our corporate resolutions," Acting Criminal Division chief Kenneth Blanco said in a March 10 speech on white-collar crime. Its goal is to provide prosecutors, companies and the public "clear metrics for what constitutes voluntary self-disclosure, full cooperation and full remediation" and the benefits the DOJ will accord to each. The one-year pilot period ends on April 5, when the DOJ will begin evaluating it for extension or revision. During the review process, the DOJ will continue the program.

Because the fraud section's FCPA group has been active in normalizing its practices in corporate resolutions, its pilot program should increase transparency and predictability for companies undertaking settlements in that area. If so, corporations caught in an investigation could soon

have better benchmarks for the road between violation, resolution and ultimately a working compliance and ethics program with or without the guidance of a monitor.

Benefits of Monitorship

If the monitor is imposed on a company as part of a criminal settlement, the benefits of the position might not jump out to the business.

But experienced monitors highlighted a number of ways that a successful monitor can protect a company and save it money in the medium to long run.

First, the monitor knows what the agency expects in compliance and ethics programs. The monitor has talked to the prosecutors candidly about what their investigation of the crime revealed and what the agency thinks went wrong. He or she also knows what successful compliance and ethics programs look like and often has industry experience, as well. The monitor typically knows a shorter path between where the compliance program is now and where it must ultimately go.

As an outsider, the monitor is also able to referee between different parts of the organization that might not work well together or that have become unbalanced. "A successful monitorship for an entity with a broken culture helps fix the culture and install a new one," lawyer and monitor Anthony Barkow said. Barkow, co-chair of Jenner & Block's white-collar defense practice, said that the problem can stem from tension between the compliance and business units of the organization. In those situations, a monitor can add value that outlasts his or her tenure by re-empowering legal and compliance in the hierarchy of the business, he said.

Furthermore, as an outsider, the monitor can act as a barrier between the company and forces that pressure it to reoffend. Veteran New York monitor Ronald Goldstock, who has extensive experience with companies that had been paying extortion or bribes, sees real value in giving companies a clear excuse to rebuff new overtures from those corrupt influences: The company can't keep paying, because this monitor is watching every move. If a company's industry or environment has heavy criminal involvement, a monitor can be the cover needed to pursue a different course.

The ultimate benefit, of course, comes in implementation of a working compliance system and improved ethics at the corporation. That not only helps the corporation with its current predicament, but can pay for itself many times over in avoided penalties and litigation.

Schwartz said that, in his experience, the government agrees to a monitor because the offending entity "was genuine in its efforts to achieve best practices." In other words, appointment of a monitor is a vote of confidence that the entity can make things right and is prepared to invest fiscal and intellectual resources to that goal. One of the benefits of monitorship, Schwartz reasons, is that "monitoring is a constructive engagement meant to help improve and institutionalize best practices." The monitor's vigilance and expertise in getting the corporation to that goal is a big asset, he said.

Steps to Success

First, most monitors said that tone from the top is the critical piece in ensuring that a company is successful in adopting a working compliance and ethics culture that will endure long after the monitor leaves.

"Does management consider itself to be above the rules?" asked Hanson. He pointed out that everything an executive or leader does is scrutinized by other employees, so it is important to remember that all of a leader's actions should set an ethical tone.

Second, monitors focus on ethics, in addition to compliance, in order to effect changes that last within the organization. "Compliance is terrific," Schwartz said, but compliance is primarily about just staying within the law, while "ethical culture is about doing the right thing." Ethical culture acts as

a safety net for the corporation, even if it operates across different branches and geographies, he said. As noted above, that ethical tone must come from the highest levels of leadership to affect the corporate culture.

Third, Schwarz underscored that empowering people to ask questions is a sign of strength, not weakness. But to do that, someone has to be ready and able to answer, he said. The compliance team has to have enough understanding of the business that it can address any information it gets from the business side and so that the business side feels comfortable going to the compliance personnel and believes a good outcome will result.

Several monitors concurred, emphasizing that compliant corporations both make raising concerns an obligation and provide all employees with open avenues to do so. One monitor identified training as key, including training those who receive these questions and concerns to divorce the message from the messenger. Vital information can come from an employee the company does not highly value or someone in a far-flung division.

Several monitors also suggested appointing a project manager/leader for compliance within the organization immediately when the corporation discovers a problem. That person will have a key role in the investigation, and can be the key interface/point of contact with the monitor. While the monitor will need to talk to a variety of people within the organization, having an internal lead for the effort helps, several monitors said. In most all cases, the monitor is not conducting another investigation, monitors stressed. Instead, his or her work is forward-looking — it is about future compliance. But clear communication from within the corporation about what went wrong before and how it was discovered and investigated helps, they said.

Goldstock says that the most important question he asks a corporation is "why?" Asking why a corporation does things the way it does—or always had done — is important not just for the information but for the insight into the culture, he said. Understanding people, and understanding the incentive structure within a corporation, are critical to getting the corporation where it needs to be, Goldstock added.

"Big problems come in small packages," Schwartz said. "Often the problem occurs in a distant region, small business unit, unit being sold, unit just acquired, low revenue compared to other units, etc." He said that a successful compliance culture is available to the whole company, with clear lines of authority and communication so that all segments of the operation can report problems and get help from compliance to stay within the law.

Hanson, president of the International Association of Independent Corporate Monitors, maintains a public resource center on the association's website that serves as a repository of past corporate resolutions and available information about independent monitors. The association also has a code of conduct, which members agree to abide by, and a list of members with their experience and contact information. He said that the association is devoted to improving transparency, standards and uniformity among agencies in monitor appointments; companies can peruse the site for information about criminal settlements with different enforcers, monitorship provisions and monitors with experience in their specific industry.

Different Regimes

Monitors made a point to note that the DOJ accounts for only about 20 percent of the monitors imposed on corporations in the U.S. The rest are appointed by other federal agencies or by state enforcers.

Each authority has different procedures and rules for monitorships, Hanson said, and the scope of the appointment differs based on the authority involved. Experience with a specific enforcer is therefore important, and a company's experience negotiating a criminal settlement with the DOJ might not translate to negotiations with a state

authority. If a violation like widespread fraud has occurred, the company must be prepared to navigate the process at different levels and with multiple agencies.

Finally, other countries now also require a monitor at corporations that admit major fraud. For example, Rolls Royce Plc paid the U.S. about $170 million as part of an $800 million global resolution of corruption investigations in the U.S., U.K. and Brazil. Rolls Royce entered into a deferred prosecution agreement in the U.S. and in the U.K. Rolls's U.K agreement appoints a monitor, Lord David Gold, for a term of five years.

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