CORPORATE MONITORS:
LOOKING BACK AND LOOKING FORWARD

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Corporate monitors have existed in various fashions for decades. In the wake of the rash of securities frauds in the early 2000s, the financial crisis later in the decade, and increased Foreign Corrupt Practices Act scrutiny, the concept of a "corporate monitor" has become near ubiquitous. This highly-specialized practice area involves the imposition of an independent third-party by a court, government agency or department upon an organization. The monitor traditionally performs a specific set of functions, such as ensuring the organization's compliance with the terms of a settlement agreement between the organization and the government.

This field of corporate monitors is ripe for continued growth and expansion. Judge Jed Rakoff, writing in 2003 about a specific corporate monitor, unknowingly observed the beginning of a trend:

> While the Corporate Monitor's efforts were initially directed at preventing corporate looting and document destruction, <u>his role and duties have steadily expanded</u>, with the parties' full consent, to the point where he now acts not only as financial watchdog (in which capacity he has saved the company tens of millions of dollars) but also as an overseer who has initiated vast improvements in the company's internal controls and corporate governance.[2]

The goal of this Article is to provide the reader both a historical and forward-looking view on corporate monitors. This Article will largely discuss corporate monitors in the DOJ and SEC context.

I. History of Corporate Monitors

In the legal world, the concept of a monitor is nothing new. For decades, courts have used court-appointed agents in a range of legal fields, spanning bankruptcy to family law.[3]

The role of corporate monitors appears to have come en vogue in the early 2000s. Generically speaking, a corporate monitor "is an independent third party who assesses and monitors a company's adherence to the compliance requirements of an agreement that was designed to reduce the risk of recurrence of the company's misconduct."[4] Essentially, a corporate monitor is

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[2] *SEC v. WorldCom, Inc.*, 273 F. Supp. 2d 431, 432 (S.D.N.Y. 2003).

[3] For an excellent, in-depth discussion of the history of monitors, see Veronica Root, *The Monitor-"Client" Relationship*, 100 VA. L. REV. 523 (2014).

[4] DOJ and SEC, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* ("FCPA Guide") at 71. While this language is provided in the FCPA context, it provides a solid, broad definition.

"the clean up person"—the person who comes in after problems have already been discovered, and often as part of a company's remediation efforts in satisfying government demands.

Judge Rakoff, when presiding over the above-quoted *WorldCom* case, approved the SEC's novel remedy: a request for an appointment of a "Corporate Monitor." Interestingly, in that case, the court directed the parties to jointly propose a name for the monitor to the court within five days.[5] Even just within this case, the role of the corporate monitor rapidly expanded. At first, the monitor was charged with just two main tasks—prevent the destruction of evidence and approve or disapprove all compensation payments to Executives.[6] However, through subsequent court orders and eventually the SEC Consent Decree, the monitor's role in *WorldCom* became to review WorldCom's corporate governance and to issue recommendations concerning WorldCom's future governance structure.[7] These broad charges accompanied by sweeping authority resemble what we understand, today, as a corporate monitor's role.

Scholars who study the rise of the modern-day monitorship suggest it is an outgrowth of three related phenomena:

1. the evolution of the use of traditional, court-appointed agents,
2. an increase in the complexity of regulatory and legal requirements facing organizations, and
3. the use of external gatekeepers to assist organizations in their efforts to comply with a more challenging and demanding regulatory environment.[8]

Practical experience confirms this scholarly intuition. Any practitioner reading this Article—whether from the legal, accounting, consulting, financial, or other field—will certainly agree that, for our clients, the maze that is our current business environment only continues to develop new twists and turns, which requires deft navigation.

II. When Is a Compliance Monitor Appropriate?

Simply put, whether a monitor is appropriate depends on the specific facts and circumstances of the case. In criminal cases, a company's sentence, or a deferred prosecution agreements (DPA) or non-prosecution agreement (NPA) with a company, may require the appointment of an independent corporate monitor. Similarly on the civil side, a company may be required to retain an independent compliance consultant or monitor to provide an independent, third-party review of the company's internal controls.

That said, not all cases require the appointment of a corporate monitor. A good starting point in determining whether a monitor is appropriate is the Guidance provided by the DOJ and SEC.

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[5] See Stipulation and Order at 3, *SEC v. WorldCom, Inc*., No. 02 Civ. 4963 (S.D.N.Y. June 28, 2002) ("WorldCom Stipulation and Order").
[6] WorldCom Stipulation and Order at 2-3.
[7] *See* Judgment of Permanent Injunction Against Defendant WorldCom, Inc., *SEC v. WorldCom, Inc*., No. 02 Civ. 4963 (S.D.N.Y. Nov. 26, 2002).
[8] Veronica Root, *Modern Day Monitorships*, YALE JOURNAL ON REGULATION, Volume 33 (2016).

The factors the DOJ and SEC consider when determining whether a compliance monitor is appropriate include:

- Seriousness of the offense
- Duration of the misconduct
- Pervasiveness of the misconduct, including whether the conduct cuts across geographic and/or product lines
- Nature and size of the company
- Quality of the company's compliance program at the time of the misconduct
- Subsequent remediation efforts.[9]

In 2008, DOJ issued internal guidance regarding the selection and use of corporate monitors in DPAs and NPAs with companies. Additional guidance has since been issued and is discussed in the subsequent section.[10]

III. Selecting a Monitor: DOJ Guidance—Morford and Breuer Memoranda

Approximately ten years ago, there was an outcry for guidance regarding corporate monitors.[11] At this time, then-U.S. attorney Chris Christie approved a contract worth approximately $52 million for his former boss (and former attorney general) John Ashcroft to serve as the compliance monitor for the medical device company Zimmer Holdings. Ashcroft's appointment was to last 18 months. This controversy led to congressional inquiry and threatened law-making.

In response, the DOJ issued what is commonly referred to as the "Morford Memo," a policy memorandum discussing the selection and use of corporate monitors in pre-trial diversion agreements. A year later, the Morford Memo was supplemented by a memorandum issued by Lanny Breuer on June 24, 2009 entitled "Selection of Monitors in Criminal Division Matters." Then again in 2010, Gary Grindler issued additional guidance on the use of monitors in DPAs and NPAs.

According to these memoranda, the selection process for a monitor should, at a minimum, be designed to:

1. Select a highly qualified and respected Monitor based on suitability for the assignment and all of the circumstances;

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[9] FCPA Guide at 71.

[10] See Craig S. Morford, Acting Dep. Att'y Gen., U.S. Dept. of Justice, Mem. to the Heads of Department Components and United States Attorneys on Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations (Mar. 7, 2008) ("Morford Memo"); see also Lanny A. Breuer, Assist. Att'y Gen., Dep't of Justice, Mem. to All Criminal Division Personnel on Selection of Monitors in Criminal Division Matters (June 24, 2009) ("Breuer Memo"); see also Gary G. Grindler, Acting Dep. Att'y Gen., U.S. Dept. of Justice, Mem. to the Heads of Department Components and United States Attorneys on Additional Guidance on the Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution (May 25, 2010).

[11] Philip Shenon, *Ashcroft Deal Brings Scrutiny in Justice Dept.*, New York Times (Jan. 10 2008).

2. Avoid potential and actual conflicts of interest and;
3. Otherwise instill public confidence.[12]

This requires that "the corporation and the Government [] discuss the necessary qualifications for a monitor based on the facts and circumstances of the case."

Additionally, a fair amount of emphasis is placed on avoiding conflicts of interest and perceived conflicts of interest.[13] The Morford Memo states that the monitor is not an "agent of the corporation or of the Government."[14] To avoid conflicts, the Morford Memo instructs government attorneys to create a standing or ad hoc committee to consider monitor candidates. Further, the Morford Memo explicitly prohibits U.S. Attorneys and Assistant Attorneys Generals from unilaterally making, accepting, or vetoing monitor candidates. And, the Office of the Deputy Attorney General must approve the monitor. Finally, the Government should obtain a commitment from the corporation that it will not employ or be affiliated with the monitor for a period of at least one year from the date the monitorship is terminated.

That said, of course, there is still much perception by both the public—and at times the corporation—that the monitor is simply the government's agent. Both Memos direct that the pool of candidates for a monitor should come from the Company, not the DOJ. This emphasis on avoiding perceived conflicts is particularly salient given the current political and business climate in which corporate watchdog organizations and political groups regularly seek to oust any suspicious corporate behavior that could indicate inappropriate behavior.

The monitor's charge in the Memos is fairly straightforward: to enforce a DPA or NPA. But, a corporate monitor is also responsible for: (1) investigating the extent of the wrongdoing already detected and reported to the government; (2) discovering the cause of the corporation's compliance failure; and (3) analyzing the corporation's business needs against the appropriate legal and regulatory requirements. A monitor then provides recommendations, to both the corporation and the government, to assist the corporation in its efforts to improve its legal and regulatory compliance.[15]

Defaulting to a former federal prosecutor may be the correct choice for many companies, however other options should not be overlooked. It is critical for companies to pick a monitor who understands *their* business, not just someone who knows compliance generally and how to work with the government (though those are necessary qualifications). For example, a financial institution would do well to pick a monitor who has deep understanding of the legal and regulatory issues as well as an understanding of finance and accounting.[16] Companies, the

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[12] *See* Morford Memo; Breuer Memo.
[13] Morford Memo.
[14] *Id.* at 4.
[15] *Id.* at 6.
[16] For example, Standard Chartered Plc, a U.K. bank, twice fined by US authorities for breaching sanctions and transaction-reporting rules. Its monitor, Ellen Zimiles, is both a former federal prosecutor and head of global investigations and compliance and is the financial risk and compliance segment leader at consulting firm Navigant. Monitors such as Zimiles bring the legal and business understanding to the monitorship role.

monitors themselves, and the government all have a vested interest in the selection of a competent monitor who is awarded the job based on more than just prior positions held.

IV. Guidelines Governing Monitors

Once a corporate monitor is in place, it is bound to adhere to certain principles, a number of which are outlined below. These come from the Morford Memo.

- Independence: The monitor must be an independent third party, not an employee or agent of the company or the Government.
- Supervision: The monitor should regularly assess the company's compliance with the terms of the Settlement Agreement.
- Scope of Oversight: The scope of the monitor's work should be no broader than necessary to address and reduce the risk of recurrence of the company's misconduct.
- Reporting: The Government, the company, and the monitor should communicate freely and the monitor should make periodic written reports where appropriate.
- Implementation of Monitor's Recommendations: The company is not required to implement the recommendations of the monitor. However, the Government must be notified if the company refuses and may consider this in evaluating whether the company has satisfied its obligations under its Settlement Agreement.
- Recurrence of Misconduct: The Settlement Agreement should clearly identify any types of misconduct that the monitor must report directly to the Government. The monitor shall also have discretion to report evidence of other misconduct to the Government, the company, or both.
- Duration: The duration of the monitor's appointment should be specific to the problems that exist and the types of measures necessary for the monitor to satisfy its mandate.
- Extension and Early Termination: The Settlement Agreement should provide for an extension of the monitor's service at the discretion of the Government and should provide for early termination when appropriate.[17]

V. Current Issues

A. Disclosure/Confidentiality

As discussed above, the Monitor, as part of her basic duties, must give the government reports on the progress of improving compliance. However, this begs the question of whether the monitor's reports that are given to the government should be accessible to third parties. The monitor's reports will inevitably contain unprivileged, confidential and proprietary business information of the corporation.

One potential solution is to insist on language in the DPA or NPA that reflects the parties' intentions to maintain the confidentiality of monitor reports.[18]

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[17] Morford Memo.

[18] For example, see DPA ¶ 15, *U.S. v. WakeMed*, No. 5:12-cr-00398 (E.D.N.C. Feb. 8, 2013) (the Government will treat the Monitor's reports as ‘‘confidential commercial information’’ as that term is

That said, even if the government is willing to maintain confidentiality of a monitor's reports, the press, litigants, and competitors may seek out this information. Unfortunately, there is a dearth of case law regarding whether or not monitor reports can be disclosed to third parties. In May 2013, the U.S. District Court for the Northern District of Texas ordered DePuy Orthopaedics, Inc., a manufacturer of hip and knee joint replacement devices, to produce six of its corporate monitor's quarterly reports in civil discovery.[19] Granted, the court did ensure certain confidentiality protections for the report, however other than these confidentiality points the reports were ordered produced in full. The court did not find doing so overly burdensome or creating an undue hardship to the company.

However, not all courts conclude the same. That same year, the D.C. Circuit overturned a district court's order of disclosure of a monitor's reports in *S.E.C. v. AIG*.[20] In this matter, a reporter, Sue Reisinger, sought the monitor reports, claiming the reports were judicial records to which she had a common law right of access. After two failed Freedom of Information Act (FOIA) requests, Reisinger moved to intervene in the AIG Action to obtain the reports. She reasoned that ''the public has a right to know how a company whose corporate governance was under [the monitor's] intense scrutiny could engage in such risky and costly behavior.''[21] The court, in denying her request, held a corporate monitor's report, simply by virtue of being filed with the court, does not become a public record.

This issue persists. Earlier this year, HSBC faced this exact issue and found themselves forced to disclose the monitor's report.[22] An individual suing HSBC over a mortgage loan modification requested that the monitor's report be released. In a footnote that could have wide-sweeping effects, Judge Gleeson for the Eastern District of New York, discussed HSBC and the government's argument that the report would not have relevant information to Moore. However, Judge Gleeson concluded, "The Monitor's Report could have no useful information for Moore, and he—as a member of the public—would still have a right to see it."[23] This far-reaching standard could present serious trouble to companies in the future who want their monitor's reports kept private.
Of note, it was not just HSBC arguing that these reports should be kept confidential; the government lawyers, too, argued against disclosure, saying disclosure would endanger "the viability of other current and future monitorships," while giving would-be criminals a road map to exploiting HSBC's anti-money-laundering weaknesses. While the court acknowledged this argument, it ruled that public-interest concerns trumped those expressed by HSBC and the government. "My oversight of the DPA and the open criminal case goes to the heart of the

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used in the Freedom of Information Act); see also DPA, Attachment D at D-13, *U.S. v. Bilfinger SE*, No. 4:13-cr-00745 (S.D. Tex. Dec. 9, 2013) (proving an example of standard FCPA DPA language).

[19] *See In re DePuy Orthopaedics, Inc. Pinnacle Hip Implant Products Liab. Litig.*, MDL No. 3:11-MD-2244-K, 2013 WL 2091715, at *1-3 (N.D. Tex. May 15, 2013).

[20] 712 F.3d 1, 5 (D.C. Cir. 2013).

[21] Letter from Sue Reisinger to U.S. District Judge Gladys Kessler, *S.E.C. v. Am. Int'l Group*, No. 4-cv-02070 (D.D.C. Apr. 29, 2011).

[22] See *USA v. HSBC Bank USA, N.A. et al.*, No. 1:12-cr-00763-JG (Jan. 28, 2016).

[23] *HSBC Bank* at n. 4.

public's right of access: federal courts must 'have a measure of accountability,' and the public must have 'confidence in the administration of justice.'"[24]

B. Cooperation Among All Parties

For any monitor relationship to work, the company must "play nice" with the monitor and adhere to the terms of the DPA or NPA. In a monitor report issued last year, the company's monitor had less-than-positive remarks to make about the company's behavior. While it could be expected that a monitor's report identifies remaining weakness areas, something a company should strive for is ensuring that all its employees cooperate with the monitor and compliance efforts. In this particular instance, the monitor's summary report found that "interactions with both internal audit and [compliance] were marked by combativeness, overblown complaints about factual inaccuracy, and a basic lack of co-operativeness." In at least one instance, a bank manager shouted at an internal auditor who was critical of his work. Given the potential trend that may lead to more public disclosure of monitors' reports, a company should endeavor to not have negative statements such as these broadcast.

Related to this point, the government, monitor, and company should understand their roles in order to ensure the best possible working relationship and smooth resolution of the issues at hand. At a high level, the government should ensure the selection of an independent monitor. From the company's standpoint, it is important to provide the monitor with the necessary support. This comes in both the form of material support—staff, technology, access to information—and also in the form of corporate culture support. Employees should know that they should not view the monitor as the "bad guy," but rather should cooperate. Executives and the Board of Directors should work to set the tone of cooperation from the top. As for the monitor, he should provide an independent analysis of the company. Most critically, open channels of communication between these three parties must exist at every turn, and expectations should be continually revisited.

C. Who Monitors the Monitors?

1. ABA Guidelines for Monitors

In August 2015, the American Bar Association ("ABA") House of Delegates approved "black letter" standards that will—for the first time—provide a framework through which corporate monitors, legislatures, courts and administrative agencies can make decisions on developing and implementing an organization's corporate compliance and ethics program.[25]

This work originally began with an Ad-Hoc Task Force on Corporate Monitor Standards, that was assembled by the Criminal Justice Section (CJS) of the ABA in 2010. In late December 2013, after over two years of study on the topic, the Ad-Hoc Task Force was disbanded and a formal Standards Committee designated to develop the Standards. After two readings before the

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[24] *Id*. at 6.
[25] ABA Standards for Monitors (August 2015).

CJS Council, these Standards were passed by the CJS Council in April 2015 and presented to and approved by the ABA House of Delegates in August 2015.[26]

These Standards, broadly drafted, are applicable to those serving in monitorships beyond the traditionally conceived DOJ monitors with which we are familiar. That said, these Standards only technically apply to attorneys. While many monitors are attorneys, these Standards can be broadly construed as "best practices" for anyone serving as a monitor.

2. Formation of the International Association of Independent Corporate Monitors (IAICM)

John Hanson, a thought leader and expert in the field of independent corporate monitoring, as well as a repeat corporate monitor, is in the process of forming the International Association of Independent Corporate Monitors ("IAICM").[27] The IAICM is a 501(c)6 not-for-profit membership organization serving those who practice in this field and is presently developing a Code of Professional Conduct that will establish Standards for its members. Per Hanson, the IAICM's forthcoming Code, though consistent with the ABA Standards, may cover additional areas and/or delve more deeply into some areas than the Standards.[28]

VI. Future of Monitors

The entire field of corporate compliance has rapidly changed over the past fifty years. For instance, the C-Suite role of Chief Compliance Officer is itself a recent development: Scott Cohen, editor and publisher of Compliance Week, dates the proliferation of Chief Compliance Officers to a 2002 speech by SEC commissioner Cynthia Glassman, in which she called on companies to designate a "corporate responsibility officer."[29]

Thirty years ago, proxy advisory services did not exist; now, they have become a powerful force in American corporate governance. So too, does it seem to be with corporate monitors. For now, corporate monitors remain a role necessary to be filled because of governmental requirements, often in the FCPA context. However, in the future, perhaps the Board of Directors, shareholders, or even the public at large will demand periodic monitoring of companies, even in the absence of potential legal violations. It is a field ripe for growth.

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[26] John Hanson, American Bar Association Adopts Standards for Corporate Monitors (September 15, 2015).
[27] The IAICM, while yet to establish a web page, does have a Facebook and Twitter page. Additional research indicates several senior counsel at various firms have joined the IAICM's Board of Directors.
[28] John Hanson, American Bar Association Adopts Standards for Corporate Monitors (September 15, 2015).
[29] Linda Tucci, Spotlight turns to chief compliance officers (Aug. 25, 2005).