New Principles Can Help Advance Independent Corporate Monitoring

*By Vincent L. DiCianni**

As government regulators, federal and state prosecutors search for effective alternatives to prosecutions, they are increasingly using deferred prosecution agreements (DPAs) or non-prosecution agreements, which include some form of monitoring. However, the frequent appointment of former government officials to serve as monitors has left some questioning the independence and integrity of the monitoring process used in such agreements. To address these concerns, the U.S. Department of Justice (DOJ) recently issued a memorandum outlining the "best practice" principles for choosing monitors.

Explaining the reasons for issuing the principles in his March 7, 2008 memo to U.S. Attorneys, Acting Deputy Attorney General Craig S. Morford wrote: "The corporation benefits from expertise in the area of corporate compliance from an independent third party. The corporation, its shareholders, employees and the public at large then benefit from reduced recidivism of corporate crime and the protection of the integrity of the marketplace."[1]

The memo's intent is to provide "a series of principles for drafting provisions"; thus, the principles are not an end in themselves, but a guide to potential provisions of an agreement. The memo's stated purpose is to provide "only internal Department of Justice guidance" and a further limitation notes that the memo "applies only to criminal matters and does not apply to agencies other than the Department of Justice." Yet the principles stated also can provide useful guidance for state courts, regulatory agencies, and other oversight authorities that may use or advocate the use of monitors.

Standard principles are warranted, as the use of independent corporate monitors has become "almost commonplace"[2] in recent years. Monitors commonly are associated with DPAs and other pretrial agreements, which "have been used with more frequency recently to resolve a wide variety of criminal investigations, ranging from accounting fraud to tax fraud to violations of the FCPA (Foreign Corrupt Practices Act)."[3]

Monitors have been used in cases involving well-known companies such as America Online (AOL), Bristol-Myers Squibb, and American Insurance Group (AIG). The Securities and Exchange Commission (SEC) also is using them frequently in enforcement actions, such as in its action against WorldCom.[4]

The use of monitors is increasingly common in state courts as well and they are sometimes used in cases when there is no prosecution involved. Monitors have been used in high-profile cases, such as the 2002 case against Arthur Andersen executives involved with Enron,[5] and also are used by administrative agencies in cases involving regulatory violations.

What Is a Monitor and How Are They Used?

An independent corporate monitor is a person or entity who has in-depth knowledge and experience with regulatory schemes and oversees businesses that have been sanctioned for violating one or more regulations. The monitor's role is to provide both oversight to protect the public and guidance to help the corporation comply with regulations on an ongoing basis. The corporation pays the monitor and, in

exchange for agreeing to ongoing oversight, typically avoids other sanctions, such as having a license to practice suspended. In this respect, monitors can help the courts save time and reduce their backlog, as well as provide employee compliance training and oversight to reduce the likelihood of recidivism.

Describing the monitor's role, the Morford memo says that, once an agreement is reached for how to prevent future misconduct, "A monitor's primary responsibility is to assess and monitor a corporation's compliance with the terms of the agreement specifically designed to address and reduce the risk of recurrence of the corporation's misconduct, and not to further punitive goals." More specifically, the memo says the monitor should "oversee a company's commitment to overhaul deficient controls, procedures and culture."[6]

Origins of Corporate Monitoring

While receiving increasing attention today, corporate monitoring is not a new concept. It has its roots in the late 1960s, when monitoring programs were created to help rehabilitate juveniles and first offenders. Pilot programs in Washington, D.C. and New York City provided offenders with counseling, training, and job placement in lieu of prosecution, in the hope that the programs would reduce recidivism.[7]

Corporate monitoring was further inspired by the federal Inspector General Act of 1978, which created an inspector general to prevent and detect fraud, waste, and abuse for each of 12 major federal civilian agencies. The inspector generals' combination of auditing and investigating responsibilities and statutory guarantee of independence are key characteristics of today's independent corporate monitors.[8]

Perhaps the most successful pioneering program for corporate monitoring is the Independent Private Sector Inspector General (IPSIG) program developed in New York in response to the 1989 report, *Corruption and Racketeering in the New York City Construction Industry*.[9] The issuing of the Federal Sentencing Guidelines in November 1991, shifting policing responsibilities from the government to the corporation, provided a boost for the IPSIG model by recommending less stringent penalties for companies that took steps to detect and prevent fraud, report misconduct promptly, and create a culture in which high-level officials did not participate in or condone criminal activity.[10]

The IPSIG program, which was used to investigate the theft of scrap materials from The World Trade Center site after 9-11, created an ongoing monitoring program for construction companies with large state contracts. It requires the contractors to maintain a 24-hour hotline that employees and others can use to report any wrongdoing; it also provides monitors with ongoing access to financial reports and other records, and to employees. IPSIG monitors professionals in the healthcare, accounting, and insurance industries, and businesses and individuals that contract with the state government.

The IPSIG model utilizes private sector resources and expertise as

> an independent, private sector firm (as opposed to a governmental agency) that possesses legal, auditing, investigative, and loss prevention skills, that is employed by an organization (i) to ensure that organization's compliance with relevant laws and regulations, and (ii) to deter, prevent, uncover, and report unethical and illegal conduct committed by the organization itself, occurring within the organization, or committed against the organization. Notably, an IPSIG may be hired voluntarily by an organization or it may be imposed upon an organization by compulsory process such as a licensing order issued by a governmental agency, by court order, or pursuant to the terms of a deferred prosecution agreement.[11]

The independent monitoring model that has evolved differs somewhat from the IPSIG model, which has been criticized by some who feel that IPSIGs can be too intrusive into areas of a company that have nothing to do with the matter at hand.

The increased focus on corporate scrutiny resulting from the 2001 Enron scandal created another boost for the use of corporate monitors. Until recently, "a prosecutor's choices, when faced with corporate wrongdoing, were essentially binary: he or she could either bring charges or decline prosecution, with no middle ground allowing for continued supervision or enforced remediation."[12] Because of the rigidity of existing standards, prosecutors sought "a way that would enable them to exercise their discretion not to charge a corporation in appropriate circumstances but that would, at the same time, give them sufficient leverage to require significant changes in corporate culture, compliance and controls and, as importantly, monitor those changes for a reasonable period of time. Thus was born the corporate deferred prosecution agreement (DPA) and its adjunct, the Independent Monitor."[13]

Monitoring of the Healthcare Profession

While the DOJ memo focuses specifically on monitoring in a corporate setting, its guiding principles and model are applicable in most regulated businesses and professions. Monitoring is especially appropriate for highly regulated, service-intensive industries, such as the healthcare industry. And while it has been used for high-level corporate crime, it also can be effective for inadvertent and minor regulatory violations, which have clogged the courts and regulatory agencies, and have resulted in delayed and protracted proceedings.

Few regulated businesses face the level of regulatory obligations and oversight that medical practitioners face, where a violation could result in the loss of a license to practice. In addition to patient care responsibilities, practitioners must navigate the complexities of healthcare billing and record-keeping requirements, OSHA, HIPAA, and CDC guidelines, and other government regulatory obligations and network provider responsibilities.

A single complaint to a state licensing board or federal regulatory agency, an intensive peer review, or an audit by a third-party payor, can trigger a series of inquiries and investigations that could lead to loss of network provider status, suspension or loss of license, loss of malpractice insurance coverage, steep fines, or forced closure of a practice.

Today, as an alternative, monitors are being used with increasing frequency to address compliance issues in matters involving provider-patient boundary violations, Medicaid and Medicare fraud, record keeping deficiencies, improper delegation of patient-care functions, over-prescribing of medications, and many other types of cases.

The Morford Principles

Independent corporate monitors will never be the right option for every case, but requiring independent oversight can be appropriate in a number of instances. In determining whether a case is suitable for the use of a monitor, the Morford memo suggests that, "In negotiating agreements with corporations, prosecutors should be mindful of both: (1) the potential benefits that employing a monitor may have for the corporation and the public, and (2) the cost of a monitor and its impact on the operations of a corporation."[14]

When a cost-benefit analysis makes monitoring a viable option, the Morford memo sets out nine principles covering the selection of monitors, scope of duties, communications, and duration of any

agreement to retain monitors.

Selection of Monitors

Independence, experience, and integrity of the monitor are the key elements in the selection process, as monitoring has come under justified criticism in some cases where the independence of the monitor was in question. Some corporate defense attorneys have expressed concern over the appointment of monitors who may not be completely impartial, and have maintained that monitors who are put in place by government officials represent government agencies to the potential detriment of corporations.

For example, the U.S. Attorney for the District of New Jersey, who worked for former U.S. Attorney General John Ashcroft, came under scrutiny recently for appointing Ashcroft as a monitor for Zimmer Holdings.[15] In addition to the perceived conflict, critics cited the cost, which is predicted to range between $28 million and $52 million.[16].

When the deal came to light, the chairmen of the U.S. Senate and House Judiciary Committees requested an inquiry by the Government Accountability Office. Soon after, Representative Frank Pallone (D-NJ) introduced legislation that would require the Attorney General to issue guidelines to help determine when U.S. attorneys should enter into a DPA.[17] The action may have influenced the decision by the Office of the Deputy Attorney General to issue the memo containing principles for appointing monitors. The Morford memo focuses on the application of criteria for preventing such potential conflicts.

Given the monitor's responsibilities, it is vital that monitors be impartial when performing their duties. Biases are typically the result of the unilateral selection of monitors, which would be avoided by following the DOJ's principles. A monitor's independence is, of course, as important as the independence of a judge or juror. Monitoring should be considered as a valid legal option only when a monitor can be appointed whose independence is established.

As such, the memo's principles begin with the following:

Principle 1. ***"Before beginning the process of selecting a monitor in connection with deferred prosecution agreements and non-prosecution agreements, the corporation and the Government should discuss the necessary qualifications for a monitor based on the facts and circumstances of the case."***

While recognizing that flexibility is necessary, the DOJ memo also notes the necessity for the monitor to be truly independent. The principle denunciated requires that monitors be selected based on their merits, rather than being political appointments. The selection process must, "at a minimum, be designed to: (1) select a highly qualified and respected person or entity based on suitability for the assignment and all of the circumstances; (2) avoid potential and actual conflicts of interests, and (3) otherwise instill public confidence by implementing the steps set forth in this Principle."

The memo requires a number of steps be taken during the selection process, including:

- Attorneys selecting monitors must comply with the conflict-of-interest guidelines set forth in 18 U.S.C. § 208 and 5 C.F.R. Part 2635.
- U.S. Attorneys and Assistant Attorneys General cannot unilaterally select monitors, or accept or veto their selection.
- No monitor will be appointed who has an interest in, or relationship with, the corporation or its

employees, officers, or directors "that would cause a reasonable person to question the monitor's impartiality."
- The corporation cannot employ or be affiliated with the monitor for at least a year after the monitoring relationship ends.

The memo notes that no one method of selection will cover every case, because a monitor's role may vary. However, whatever method is used, the government should determine what selection process is most effective as early in the negotiations as possible, and "endeavor to ensure that the process is designed to produce a high-quality and conflict-free monitor and to instill public confidence."[18]

The memo suggests that both sides in the matter discuss what role the monitor will play, and the skills and experience needed. The memo anticipates that, depending on the case, monitors may include former government attorneys, accountants, technical or scientific experts, and compliance experts. It recommends that at least three qualified candidates be considered in each case.

Scope of Duties

Critics of monitoring also express concern over the authority of the monitor. In some cases, monitors have been able to override the decision-making authority of the company CEO and the Board of Directors. In the WorldCom case, for example, the monitor participated in the company's business operations and was described unofficially as a company executive.[19] To address these concerns, the Morford memo spells out the breadth of a monitor's responsibilities to prevent the monitor from overstepping his or her authority, while also reinforcing the monitor's independence.

Principle 2. ***"A monitor is an independent third-party, not an employee or agent of the corporation or of the Government."***

By definition, the independent monitor is distinct and independent from the directors, officers, employees, and other representatives of the corporation. The monitor is not the corporation's attorney. Similarly, the monitor is not an arm of the government. While open dialogue with the monitor throughout the agreement is essential, all parties must understand the corporation cannot seek legal advice from the monitor, nor can the government direct the monitor.

Principle 3. ***"A monitor's primary responsibility should be to assess and monitor a corporation's compliance with those terms of the agreement that are specifically designed to address and reduce the risk of recurrence of the corporation's misconduct, including, in most cases, evaluating (and where appropriate proposing) internal controls and corporate ethics and compliance programs."***

The type of misconduct being monitored and the skills required of the monitor will vary from one case to another, but a common thread in any case where the use of an independent monitor is under consideration includes the existence of an effective compliance program. As such, "A monitor's primary role is to evaluate whether a corporation has both adopted and effectively implemented ethics and compliance programs to address and reduce the risk of recurrence of the corporation's misconduct. A well-designed corporate code of ethics and compliance program that is not effectively implemented will fail to lower the risk of recidivism."[20]

The memo recommends that the corporation should design its own compliance program, but subject to the monitor's "input, evaluation and recommendations."

Principle 4. ***"In carrying out his or her duties, a monitor will often need to understand the full scope***

of the corporation's misconduct covered by the agreement, but the monitor's responsibilities should be no broader than necessary to address and reduce the risk of recurrence of the corporation's misconduct."

In other words, the role of the monitor should be clearly defined and focused on reducing the risk of recurring misconduct.

According to the memo, "Neither the corporation nor the public benefits from employing a monitor whose role is too narrowly defined (and, therefore, prevents the monitor from effectively evaluating the reforms intended by the parties) or too broadly defined (and, therefore, results in the monitor engaging in activities that fail to facilitate the corporation's implementation of the reforms intended by the parties)."

Just as a business is more likely to succeed when it has a business plan with clearly defined goals, corporate monitors will be more likely to succeed if their duties and ultimate goals are clearly defined. The scope of the monitor's duties should be fully described in the terms of the agreement.

The memo points out that an understanding of historical misconduct may inform a monitor's evaluation of the effectiveness of the corporation's compliance with the agreement.

Communication

How and what a monitor communicates to the government agency prosecuting the case or the corporation being monitored can be challenging. The monitor must maintain impartiality, while keeping in mind the ultimate goal of helping the corporation achieve ongoing regulatory compliance.

What happens, though, when the monitor discovers previously unknown misconduct? And what if the corporation is lax in following the monitor's recommendations?

As outlined in the Morford memo, communication on any wrongdoing is, of course, necessary, but so is communication of progress made by the corporation. Reporting is a key responsibility of the monitor.

Principle 5. ***"Communication among the Government, the corporation and the monitor is in the interest of all the parties. Depending on the facts and circumstances, it may be appropriate for the monitor to make periodic written reports to both the Government and the corporation."***

Among the issues the monitor is likely to cover in a monitoring report about the party to be monitored are:

- The progress of the corporation;
- The degree of cooperation provided;
- Whether the corporation is complying with the terms of the agreement and its internal compliance program; and
- Any recommended changes that would help achieve compliance.

Principle 6. ***"If the corporation chooses not to adopt recommendations made by the monitor within a reasonable time, either the monitor or the corporation, or both, should report that fact to the Government, along with the corporation's reasons. The Government may consider this conduct when evaluating whether the corporation has fulfilled its obligations under the agreement."***

If the corporation declines to adopt a monitor's recommendation, the government should consider both the monitor's recommendation and the corporation's reasons in determining whether the corporation is complying with the agreement. A flexible timetable should be established to ensure that both a monitor's recommendations and the corporation's decision to adopt or reject them are made well before the expiration of the agreement. Sometimes the implementation of a recommendation is cost prohibitive; other times, it may interfere with legitimate business purposes. The agreement must be flexible enough to address potential barriers to full implementation of the monitor's recommendations.

Principle 7. ***"The agreement should clearly identify any types of previously undisclosed or new misconduct that the monitor will be required to report directly to the Government. The agreement should also provide that as to evidence of other such misconduct, the monitor will have the discretion to report this misconduct to the Government or the corporation or both."***

When the monitor discovers new misconduct, in many cases it should be reported directly to the government and not to the corporation, particularly if the behavior is substantive and:

Poses a risk to public health or safety or the environment;

- Involves senior management of the corporation;
- Involves obstruction of justice;
- Involves criminal activity that the government has the opportunity to investigate proactively and/or covertly; or
- Otherwise poses a substantial risk of harm.

However, the monitor should use discretion in determining whether to report allegations that may not be credible or that involve actions outside the scope of the corporation's business.

Duration

The memo notes that "any guidance regarding monitors must be practical and flexible." That flexibility extends to the duration of the agreement. In some cases, extending the agreement may be warranted. Likewise, there may be circumstances in which the monitoring agreement should be terminated early or altered. The Morford memo anticipates both circumstances.

Principle 8. ***"The duration of the agreement should be tailored to the problems that have been found to exist and the types of remedial measures needed for the monitor to satisfy his or her mandate."***

Criteria to consider when determining how long the agreement should last include:

- The nature and seriousness of the misconduct;
- The pervasiveness and duration of misconduct;
- The involvement of senior management;
- The corporation's history of misconduct;
- The corporate culture;
- The scale and complexity of any remedial measures, factoring in the size of the business;
- Any progress in implementing remedial measures before the monitoring agreement begins.

Principle 9. ***"In most cases, an agreement should provide for an extension of the monitor provision(s) at the discretion of the Government in the event that the corporation has not successfully satisfied its obligations under the agreement. Conversely, in most cases, an agreement should provide for early***

termination if the corporation can demonstrate to the Government that there exists a change in circumstances sufficient to eliminate the need for a monitor."

A monitoring agreement may be extended if warranted by circumstances, such as when a compliance program has not yet been fully implemented. Conversely, the agreement may end early when warranted as well, such as when a business unit responsible for misconduct ceases operations.

When to Use a Monitor

Although some argue the new DOJ guidelines may not go far enough to ensure uniformity in DPAs themselves,[21] taken as a whole, even critics of monitoring likely will see value in considering the principles for choosing an independent monitor as described in the Morford memo. For example, some commentators who view monitoring as an intrusion on corporate board authority wrote that, "The Morford Memo does, at a minimum, provide counsel with some new arguments when negotiating with prosecutors over whether or not such a monitorship is appropriate in a particular case, and, if so, how such monitors should be selected, supervised and compensated, and what the scope and term of their monitoring activities should be."[22]

In practice, the Morford guidelines should help standardize corporate monitoring, while at the same time allow the degree of flexibility needed to accommodate a broad range of cases. As a result, the new guidelines could foster confidence in monitoring by both prosecutors and defense teams as an alternative method for resolving both criminal charges and regulatory matters involving businesses and professionals. The ultimate success will always depend, however, on the commitment to compliance by the offending party and the transparent behavior it will be required to demonstrate.

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[1] Craig S. Morford, *Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations*, U.S. Department of Justice, Office of the Deputy Attorney General, March 7, 2008.

[2] Christopher J. Gunther and Robert M. Pollak, *Scrutiny of Corporate Monitors Is on the Rise,* Nat'l L. J., March 31, 2008.

[3] James K. Robinson, Phillip E. Urofsky, and Christopher R. Pantel, *Deferred prosecutions and the independent monitor*, Int'l J. of Disclosure and Governance, v. 2, no. 4, September 28, 2005.

[4] Jennifer O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, Villanova School of Law, paper 106, The Berkeley Electronic Press, 2008.

[5] *Tittle v. EnronCorp.*, 284. F.Supp. 2d 511, 553 n.59 (S.D.Tex. 2003).

[6] Morford memo, *supra* note 1.

[7] Harvard Law Review Association, *Developments in the law: Alternatives to incarceration*, Harv. L. Rev. 111, 1863, 1902 (1998).

[8] Stanley N. Lupkin and Edgar J. Lewandowski, *Independent Private Sector Inspectors General: Privately Funded Overseers of the Public Integrity*, NY Litigator J., v. 10, no. 1, Summer 2005.

[9] *Id.*

[10] *Id.*

[11] International Association of Independent Private Sector Inspectors General, www.iaipsig.org.

[12] Robinson, et al., *supra* note 3.

[13] *Id*.

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[16] Philip Shenon, *Ashcroft Deal Brings Scrutiny in Justice Dept*., N.Y. Times, at A1, Jan. 10, 2008.

[17] H.R. 5086, currently in the Judiciary Committee, http://www.house.gov/list/press/nj06_pallone/pr_jan22_deferredpros.html.

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[19] Jennifer O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions,* Villanova School of Law, paper 106, The Berkeley Electronic Press, 2008.

[20] Morford memo, *supra* note 1.

[21] *See Hearing on Deferred Prosecution: Should Corporate Settlement Agreements Be Without Guidelines?,* March 11. 2008 (statement of Judiciary Committee Chairman John Conyers, Jr. (D-NJ)).

[22] John F. Savarese and David B. Anders, *DOJ Issues Memo on Corporate Monitors,* Directorship, April 28, 2008.

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