Client Advisory

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Corporate Monitors: A Concept in Flux?

Independent Monitors have become commonplace on the U.S. corporate landscape. Household corporate names such as AOL Time Warner, Bristol-Myers Squibb, Monsanto, HealthSouth, Mellon Financial, Bank of New York, ITT, Computer Associates and Symbol Technologies have agreed to monitorships in connection with deferred prosecution or non-prosecution agreements. And it is not just traditional business entities which find themselves dealing with monitors. The New York Racing Association was the subject of a deferred prosecution agreement which included the appointment of a monitor. So was the University of Medicine and Dentistry of New Jersey. So was the public utility Con Edison in New York. So was a governmental agency of the City of New York, the Department of Environmental Protection.

Most people date the advent of monitorships to the mid-1990s when federal prosecutors in New York began the practice of entering into deferred prosecution agreements with corporate targets of criminal investigations and requiring the appointment of an independent monitor to oversee the corporation's adherence to and compliance with the terms of the agreement.

Actually, the concept of the independent monitor already existed - derived from the federal government's efforts to clean out the influence of organized crime from labor unions. The best-known example of that was the International Brotherhood of Teamsters, a union. Back in the late 1980s, the federal government brought a civil RICO action against the IBT and its leaders, alleging essentially that organized crime controlled the union. The lawsuit was settled in 1989 by Consent Decree, with a very involved oversight structure imposed on the IBT. Remarkably, that oversight structure is still in place today, 19 years later, at an ever-continuing cost of millions of dollars to the union treasury.

No corporate monitorship is likely to last long—if one were going to, it would presumably mean that the corporation was being a recidivist many times over; and, presumably the government would step back in, void the deferred prosecution agreement and put the company on trial.

In any event, deferred prosecution and non-prosecution agreements with their attendant monitorships have proliferated in the wake of the corporate fraud and accounting scandals earlier this decade. In the aftermath of the Enron implosion, the Department of Justice in 2002 formed the Corporate Fraud Task Force. Cases against Worldcom, Adelphia and dozens of other entities ensued. Not only were individuals in play, but also the business entities. Arthur Andersen LLP became the seminal event. It was perceived by the Department of Justice to be a repeat offender, so prosecution followed. Then the ultimate penalty was enforced: the dissolution of the accounting firm. It was a sobering experience, intensified by the Supreme Court's eventual reversal of the conviction. What ensued was the government's reluctance to impose "capital punishment" on corporate malfeasants and a new enthusiasm to influence and alter the malign corporate culture which prosecutors believed caused or contributed to the corporate wrongdoing. The deferred prosecution and non-prosecution agreements became the vehicle to do that, with the appointment of the monitor being the government's eyes and ears, at no cost to the government. But, obviously, at some expense to the company which is always responsible for the fees and expenses of the monitor.

Reports show that from 1992 to 2002, there were a total of 18 corporate deferred prosecution and non-prosecution agreements. From 2003 to 2007, there were 85 with 20 in 2006 and 38 in 2007.

As these arrangements have proliferated, so have criticisms of government over-reaching. Complaints against the government include its requiring monitorships where they do not appear to be needed; or, over-empowering monitors to remedy the wrongdoing, especially when the monitor, who is usually a former prosecutor or sometimes a former judge, has no familiarity with the business they are overseeing.

Earlier this year, there was criticism over the appointment of a monitor because of alleged cronyism. The U.S. Attorney in New Jersey appointed former Attorney General John Ashcroft as the monitor for Zimmer, a medical device company. Newspaper articles cited suggestions – advanced by members of Congress – that politicization of the process and conflict of interest had taken place.

More substantive criticism has developed arising from the way some monitors have performed their assignments. Some deferred prosecution agreements contain monitorship provisions which narrowly define the function, responsibility and areas of interest of the monitor. Some agreements grant the monitor sweeping powers, enabling the monitor to look into virtually every aspect of the business. In the case of the University of Medicine and Dentistry of New Jersey, the monitor had authority over every aspect of operations except those involving the academics of the school. The monitor was not limited to overseeing the university's compliance with a program designed to make sure that it not engage in Medicaid fraud, which had precipitated the deferred prosecution agreement. The monitor wound up making recommendations in totally unrelated areas—retention of outside counsel, hiring and firing of senior personnel, the legitimacy of no-bid contracts, the level of executive compensation, nepotism and payments to doctors for referrals to the school's medical facility. Similarly, the monitor for Bristol Myers Squibb was in place because of alleged accounting fraud, reportedly resulting from a practice colloquially known as "channel-stuffing." His broad mandate allowed him to look into an undisclosed agreement which the company had entered into with a manufacturer of generic products, causing antitrust issues. The monitor insisted that the CEO and the general counsel be terminated, and they were. There are those who believe that this broad grant of power to monitors essentially puts the government on the company's Board of Directors and constitutes excessive governmental involvement in private enterprise.

Perhaps in response to some of this criticism, the Department of Justice instituted a set of guidelines. On March 7, 2008, it promulgated a Memorandum entitled **"Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations."** It enumerates nine "principles" of which Department of Justice components are to follow that emphasize the monitors status as an independent third-party with primary responsibility for monitoring compliance with the agreement between the government and the entity at risk of prosecution.

CONGRESSIONAL INVOLVEMENT

Legislation, in the form of the pending H.R. 5086, has also been introduced in Congress which addresses to deferred prosecution agreements and the use of monitors. It requires the Attorney General to issue guidelines delineating when to enter into deferred prosecution agreements. The previously-discussed guidelines would not satisfy this requirement. The proposed legislation would require that a district court judge approve any deferred prosecution agreement and would mandate the use of a monitor.

Should **H.R. 5086** become law, public participation may increase because of the provision that authorizes the judge to review the terms of a deferred prosecution agreement "to ensure that [it] comports with the public interest." This could enable the judge to solicit input from interested parties. Something similar to that is occurring right now. In March 2005, there was an explosion at a major international oil and gas company's refinery in Texas City, Texas where 15 people were killed. Late in 2007, the company agreed to plead guilty to a violation of the risk management plan provisions of the Clean Air Act. Families of the victims objected to the plea and sentence agreement with the government,

as inadequately protecting the public interest, pursuant to the Crime Victims Rights Act. One of the victims' objections was the failure of the agreement to provide for the appointment of a monitor who would oversee the company's compliance with environmental laws. They made a public interest argument. Their application is pending before the district court in Texas and it will be interesting to see if the court decides to impose a monitor when the government is not requiring it as a condition of the settlement.

THE POWER OF THE PROSECUTION

The prevalence of deferred prosecution agreements and the use of monitors are direct results of the law's acceptance of the concept of the corporate criminal liability. Not only the concept, but the commonly held view that a corporation, or any type of entity, is criminally liable if any employee, regardless of level of responsibility, commits a criminal act within the scope of employment. Thus even if the employee is in violation of corporate policy and even if there were corporate compliance programs designed to prevent and detect such conduct a corporation would still be deemed "guilty." Such an expansive view of respondeat superior vicarious liability in the criminal context results in corporations being defenseless in the event of criminal investigation. Hence, companies are subservient to whatever prosecutors demand be included in deferred prosecution agreements.

SHIFTING LANDSCAPE

There are signs, though, of change on the horizon. Voices are being raised in criticism, both from a policy point of view and a legal perspective, over the open-ended nature of corporate criminal liability.

It is clear that corporations can commit crimes, since Congress has so stated by defining the term "person" to include corporations, and the Supreme Court sustained Congress's authority to so do in *New York Central and Hudson River RR v. United States* (212 U.S. 481 (1909)). However, Congress has not legislated how courts are to impute to a corporation the conduct and intent of its employees or agents when the conduct is criminal. The standard which the courts have used is arguably the most relaxed standard of vicarious liability imaginable. A charge to the jury from a recent trial in the District of Connecticut reads:

> "A corporation may be held criminally liable for the acts of its agent done on behalf of and for the benefit of the corporation, and directly related to the performance of the duties the employee has authority to perform. Even if the act or omission was not specifically authorized, it may still be within the scope of an agent's employment if (1) the agent acted for the benefit of the corporation and (2) the agent was acting within his authority. The fact that the agent's act was illegal, contrary to his employer's instructions, or against the corporation's policies will not necessarily relieve the corporation of responsibility for the agent's act."

This conviction is currently on appeal to the U.S. Court of Appeals for the Second Circuit. *United States v. Ionia Management*, 07-5801-CR. The legal standard governing corporate criminal liability is being squarely challenged; and, an **amicus brief** on behalf of the Association of Corporate Counsel, the National Association of Manufacturers and the Chamber of Commerce, among others, has been filed. **It notes that** the Supreme Court, in determining a corporation's vicarious liability in civil sexual harassment cases under Title VII of the Civil Rights Act, requires that liability is restricted to the acts of the supervisors; and, that the corporate employer has the affirmative defense that it had reasonable policies in place to deter the offending employee's conduct. The court reached a similar conclusion concerning corporate liability for punitive damages. It seems anomalous that a corporation has greater vicarious liability exposure to criminal charges than it does to civil punitive damages or to Title VII damages.

The Model Penal Code provides a corporation with the affirmative defense that its officers exercised due diligence to prevent the commission of the conduct constituting the criminal offense. An alternative would be to require that the prosecution prove that a corpora-

tion lacked effective policies and procedures to detect and deter criminal actions by its employees. In addition, the Model Penal Code limits corporate criminal liability to those situations in which senior corporate officers were culpable.

It will be interesting to see how this case plays out in the Second Circuit, and whether the issue will be of sufficient interest to the Supreme Court for it to review the Second Circuit's decision. One can imagine the tectonic shift if the current expansive extent of corporate criminal liability is reined in to the boundaries suggested by the Model Penal Code. No longer would corporations be essentially defenseless in the face of a government investigation. Instead of being grateful for a deferred prosecution agreement and the installation of a monitor – because the alternative is so much worse – in some cases companies might actually resist and the playing field may become a little more level.

But this is a future which no one can predict. Until that day of revelation, we will all have to continue to deal and live with the prevalence of deferred prosecution agreements and independent monitors.

For more information on deferred prosecution agreements, monitorships, government investigations and how current and proposed legislation may affect you, please contact:

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