Allaying Misperceptions About Corporate Monitors

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As an expert in the field of Corporate Monitors and a passionate advocate of Monitor reform (in the form of Standards and "best practices"), I follow news about Monitors very closely. An article recently published in the NY Times by Steven M. Davidoff ("In Corporate Monitor, a Well-Paying Job but Unknown Results") deserves comment by a knowledgeable and experienced person from this field. Unfortunately, there are many misperceptions about Monitors that mask and hinder from constructive deliberation the real issues that should be highlighted, discussed, and considered for reform in this field.

Among the most prominent of these issues is the Monitor selection and appointment process. The misperception that has evolved is that this is a "*good old boy network*" where current DOJ or other government agency officials give "*lucrative*" contracts to former co-workers or friends.

The reality is that, since 2008/2009, the DOJ has done an effective job of preventing this from happening with Monitors and that the selection process is, as I will explain more fully later, now driven by customary and effective professional service industry business development practices. The real issues and concern lies within the Monitor selection and approval process of those outside of the DOJ, who utilize Monitors more frequently than the DOJ and are presently significantly more susceptible to nepotism and/or potential abuse.

There are no hard numbers on this, but as one who tracks it as best as I am able, I would estimate that the DOJ accounts for maybe 20% (that is on the high side) of Monitors among all the agencies that use them. The rest is spread out among other federal law and regulatory enforcement agencies (particularly in the suspension & debarment area), state & local agencies, the Courts, and non-government oversight organizations (i.e. World Bank). As is often the case, the DOJ may get the most press on the topic, but that's only because they have the most high profile matters, not the most matters.

After the controversy surrounding the appointment of John Ashcroft as the Monitor of Zimmer Holdings led to congressional inquiry and threatened law-making in early 2008, DOJ responded with what is commonly referred to as the "Morford Memo," which is DOJ's most widely known policy regarding the selection and use of corporate or compliance monitors in pre-trial diversion agreements. That policy was furthered by another, lesser publicly known and/or referenced Criminal Division memo, issued by Lanny Breuer on June 24, 2009 entitled "Selection of Monitors in Criminal Division Matters." In both Memos, the pool of candidates for a Monitorship comes from the Company, not the DOJ.

According to several GAO reports ordered by the congressional inquiry, the DOJ was following its policy on Monitors quickly after institution. For those with interest, I have linked them here: June 2009, November 2009, and December 2009.

Here's the reality - there is presently no indication of any political favoritism playing any role whatsoever in the selection and appointment process for Monitors in DOJ matters by the DOJ. None. To the contrary, DOJ goes to extraordinary lengths, including applying the Morford and Breuer memos more conservatively than they require, to avoid any appearance of favoritism. To this point, though each memo could be read as to permit the DOJ to take a more active role in determining the Monitor and/or pool of Monitor candidates, the DOJ does not - it instead requires the Company to propose a pool of Monitor candidates and refuses to provide any candidate names, even if asked.

There is a simple and wholly commercial reason why many Monitors come from the ranks of former federal prosecutors. It is because the white-collar defense attorneys who represent the companies needing Monitors also come mostly from the ranks of former federal prosecutors! Business development in the white-collar defense world relies on referrals - a Monitorship is simply a business referral. This is no different than if they represent a company and refer the representation of company individuals to people in their legal network whom they ordinarily make back-and-forth referrals to and believe qualified to do a good job.

In the SAC Capital Advisors matter, there is no indication whatsoever that the DOJ gave a "*gift*" to the proposed Monitor, Bart Schwartz, a former federal prosecutor, as Davidoff suggests. It appears that Mr. Schwartz was proposed by the company in accordance with the DOJ policies described and hyperlinked earlier. Moreover, his approval appeared to be subject to judicial approval as well, adding an additional level of scrutiny and further removing it from DOJ's ability to "manipulate." As it regards Mr. Schwartz, it's not as though he is fresh out of the government and has no relevant experience in the area. To the contrary, he is a highly qualified Monitor candidate who left government service decades ago. Much like with "expert witnesses," who need not have necessarily been so qualified previously in order to be retained in a matter, many of those proposed as Monitors have never been a Monitor before. Though this is common, unavoidable, and necessary, it also provides greater opportunity for controversy, disagreement, and discord. Mr. Schwartz is a very experienced Monitor and likely to avoid such issues and be more effective and efficient than someone lacking Monitor experience. It is perfectly reasonable to expect that companies would find such persons independent of the government and propose them as Monitor candidates.

Transparency is another issue worth exploring. The Breuer Memo that I referenced and hyperlinked earlier indicates that significant documentation should exist within and around the Monitor selection process in the DOJ's Criminal Division. I am aware that such documentation is prepared and does exist, but I do not believe that it is something likely to be shared publicly. I've never filed a FOIA request, but I wouldn't bet on getting those documents if I did so. I fully appreciate the pros and cons on this issue and would like to see the DOJ explore ways to provide greater transparency in this regard.

Outside of the DOJ, where Monitors are used more commonly and frequently, transparency is largely non-existent. Many, if not most other agencies that utilize Monitors have little or no written policy around any parts of the process, from selection through reporting. Much less do they create any documentation during that process that would provide insight into how a particular Monitor was nominated, selected, and/or approved. The same goes for the Courts (i.e. Judges).

I have noticed a "practice-shift" over the last couple of years where Federal Agencies (outside of DOJ, but perhaps following in DOJ's footsteps) have begun refusing to provide the names (i.e. more than one - a "pool" of names) of potential Monitor candidates to organizations, even when those organizations request it, for fear of running afoul of "endorsement" prohibitions under 5 C.F.R. §2635.702. I wrote the US Office of Government Ethics earlier this year asking specifically about the application of any ethical requirements and/or guidance specific to Corporate Monitors, but as one might expect, received no response at all. I am not an attorney and may well be wrong about this, but I personally do not believe that §2635.702 applies in this context, so long as there is no "private gain" for the relevant government officials. I would like to see the Government Ethics Office examine this and provide specific guidance as to whether or not a government agency can provide a pool of names of Monitor candidates to a company, particularly when so requested by the company.

Greater transparency and policy/practice documentation is a real issue, particularly as more and more agencies are beginning to appreciate the value of and use Monitors in resolving issues.

Let's talk fees now. I seem to always see the word "*lucrative*" associated with Monitorship agreements in press articles - another broad and inaccurate stereotype born out of the Ashcroft/Zimmer controversy. Certainly some of the biggest Monitorships cost organizations a sizeable amount, but that is the nature of professional hourly work in complex matters within large organizations. One could apply the term "*lucrative*" as well to the fees charged by external defense counsel, subject-matter experts, forensic accountants, information technology consultants, corporate compliance & ethics consultants, e-discovery professionals, document reviewers, marketing professionals, and a whole host of others whom organization's engage long before a Monitor ever comes into the picture.

For the SAC matter, Davidoff's suggestion that the Monitor's fees "*will probably run in the millions, if not tens of millions, of dollars*" is illogical and wholly out of touch with reality. This estimate of fees seems to be more of a sensationalistic reference to the Ashcroft/Zimmer matter (which the article brings up later) than to what any reasonable person would expect having read the scope of the "Compliance Consultant" within the SAC Plea Agreement. Under this Agreement, SAC's Compliance Consultant will only perform two (2) assessments and file two (2) reports, all done within six (6) months. A third assessment and report may be required, if deemed necessary by the government.

Keep in mind that SAC Capital (now Point72) is not a mammoth organization with thousands of employees all over the world facing a multitude of risk areas. To the contrary, it appears to me that SAC is now practically nothing in terms of size and will only manage the money of its owner - meaning that the Monitor's assessments should not be very big or difficult at all, nor will they extend over a lengthy period of years, as is common to many Monitorships. SAC is hardly a traditional Monitorship and certainly not a large one likely to generate millions of dollars in fees.

Another common question relates to whether or not a Monitor actually has any impact on the organization monitored. Though I can personally fall back on my own experience as a Monitor to satisfy myself that we do, I can also look to more objective studies that support the real and positive impact of Monitors. In addition to the GAO reports I linked above, some of which address that question directly with companies that were monitored, one of the best studies that I have

seen on the question is a white paper entitled "Can Corporate Monitorships Improve Corporate Compliance?" by Cristie Ford and David Hess (I would love to see them update that paper!).

Short answer - Monitors can and do have an impact, though much of that impact relies on the substance and terms of the underlying Agreements, which really drive the scope, authority, purpose, and role of a Monitor.

Speaking of that, another important and greatly misunderstood issue is the role, authority, purpose, and scope of a Monitor. Davidoff writes: "*He is the ostensible key to ensuring that Point72 will remain on the straight and narrow. A compliance monitor or consultant is a creation of the last decade. When a corporation accused of wrongdoing agrees to settle the charges or is sentenced to probation, it is often required to pay for a monitor to ensure that it does not break the law again. The corporate monitor is to supervise the compliance procedures of the company as well as beef them up.*"

Monitors are not a creation of the last decade. While there has been an increased visible use of Monitors by the DOJ within the last ten years, Corporate Monitors go back at least two decades. Also, as previously mentioned, many people mistakenly think that Monitors are only used by the DOJ, which is just the opposite of the reality.

When a company settles a matter, a Monitor is only required around 20% to 30% of the time (even outside of DOJ), certainly not "*often*," as Davidoff suggests. In fact, this percentage has declined within the DOJ since 2008, though it shows signs of increasing, particularly as standards and best practices continue to develop around the field. Also, there is a developing trend of the DOJ and other government agencies requiring what I call a "hybrid-Monitor," which is exactly the case with SAC Capital Advisors. As best as I can tell, though the title used in these Agreements may not even contain the word "Monitor," the DOJ continues to apply Morford and Breuer principles and process and other agencies still treat the role as they would a "Monitor."

The purpose and role of a Monitor is largely misunderstood, leading to false and unrealistic expectations. Davidoff promulgates several scope-related misperceptions that have no basis in reality - such that Monitors are in place to ensure that a company "*will remain on the straight and narrow*" or that we "*ensure that it* (the organization) *does not break the law again*" or that we "*supervise the compliance procedures of the company as well as beef them up*."

The purpose and role of a Monitor is to verify an organization's timely and effective compliance with the Terms of an Agreement. An Agreement, by the way, that the Monitor had no part in devising. These Agreement Terms are most frequently associated with an organization's remediation and improvement efforts in the areas of corporate compliance & ethics programs and internal controls, largely because §8B2.1 of the United States Sentencing Guidelines ("Effective Compliance and Ethics Program") has made those areas the measuring stick of corporate liability. As a result, the Monitor's assessments and scope are often heavily weighted, in accordance with the Terms of the Agreement(s), on corporate compliance and ethics programs.

Because an Agreement is exactly that, an Agreement, the parties could choose and agree to include Terms that provide the Monitor with authorities far exceeding that which I have described as a Monitor's general purpose and role. If the parties so choose and agree, they could give the Monitor significant authority beyond merely verification and reporting, such as operational decision-

making, contracting approval/disapproval, etc.... This level of authority is extraordinarily rare among all Monitorships and presently non-existent among DOJ Agreements requiring a Monitor.

Absent some remarkably unusual Term(s) in an Agreement requiring it of a Monitor, a Monitor's purpose and role is NOT to ensure that the company "*will remain on the straight and narrow*" or "*ensure that it* (the organization) *does not break the law again*." Nobody can do that. Nobody expects that.

The Terms of the Agreement (not the Monitor) are responsible for ensuring, in principle, that the organization will have a compliance and ethics program that, in accordance with §8B2.1(a)(2) of the US Sentencing Guidelines, "*...shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct*."

To recognize and emphasize that all fraud cannot be prevented, §8B2.1(a)(2) continues: "*The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct*."

The notion that a Monitor can prevent and/or uncover all fraud within an organization is utterly absurd. It is so unconscionable that suggesting it defies all common sense.

The real scope issue lies within the Terms of the Agreement(s) underlying the Monitorship, which as noted previously, the Monitor had no part in drafting. Having been a Monitor and having read every Agreement requiring a Monitor that I can get my eyes on, it is my opinion that most of these Agreements are not constructed sufficiently so as to ensure that the monitored organizations have compliance and ethics programs that adequately comport with §8B2.1 of the US Sentencing Guidelines. While DOJ's Agreements have improved drastically in this regard over the last few years, they still too narrowly focus on the underlying issues (i.e. bribery, false claims, insider trading, etc...) and not on the <u>whole</u> compliance and ethics program, which is what §8B2.1 covers.

As a result of this, while a company may significantly improve, for example, its anti-corruption compliance program component under an Agreement with the DOJ, it may utterly fail in other risk areas subject to criminal misconduct and/or abuse. In other words, DOJ risks missing the forest for the trees by too narrowly focusing on the underlying issues and not on the overall compliance and ethics program, which if designed appropriately and implemented effectively, would address all fraud and compliance risks and better prevent recidivism. Isn't that the real spirit of what everyone wants to accomplish?

Additionally, as a compliance and ethics program expert, I feel that in these Agreements (particularly those requiring a Monitor) the DOJ and most other agencies overly focus on compliance program components and not enough on ethics and ethical tone. The title of §8B2.1 is "Effective Compliance and **Ethics** Program" (**emphasis added**) and §8B2.1(a)(2) specifically relates to ethical tone, yet rare is the instance that one of these Agreements obliges a Monitor to assess and report on an organization's ethical tone! Ethical tone and compliance programs are symbiotic - one cannot succeed without the other - and the government does not yet seem to have come to a full appreciation of it.

Another issue alluded to in Davidoff's article related, generally, to the concept(s) of "self-monitoring" and/or government monitoring. In self-monitoring, the company assesses its own performance against the terms of an Agreement and reports to the government. Government monitoring is where the relevant government agencies conduct the monitoring.

In my opinion, "self-monitoring" is an oxymoron and cannot be generally relied upon to ensure either effective compliance with the Terms of an Agreement or that the organization establishes a compliance and ethics program that achieves the desired end-results ("spiritual compliance") of an Agreement. Though many might think that trust and objectivity are the primary concerns in this regard, I have found that the real problem with self-monitoring is technical competence.

When an organization is left to its own to make these assessments, the in-house people assigned to make and/or review such assessments often simply lack the requisite corporate compliance and ethics industry experience and knowledge necessary, leading to a "check the box" process or attitude that can hinder effective and/or "spiritual compliance" with the Agreement. This is not to suggest that a Monitor should always be required, only that greater consideration of an organization's technical competence needs to be incorporated into the decision matrix as to whether or not a Monitor should be utilized.

For example, when an Agreement requires that an organization conduct some type of specific compliance training of employees, the company may genuinely believe it has effectively done so simply because they offered a training session (hence, "check the box") and therefore report successful compliance with that Term of the Agreement to the government. What I frequently find, as a Monitor and compliance consultant, is that such training was not effective - meaning that those employees at risk to a compliance issue could not reasonably recognize the relevant compliance and ethics risk(s) or apply the relevant policies within the context of their role(s) (hence my term, "spiritual compliance").

The same lack of compliance & ethics industry technical competence exists within the ranks of relevant government agencies as well, where it is exacerbated by agency budget/resource issues, making fruitful and effective compliance monitoring by the government unrealistic, if not impossible. The agencies that have the combination of technical competence and resources are very few (i.e. HHS) and even those utilize Monitors from time to time.

Self-monitoring and/or government monitoring assumes an expertise that is presently uncommon among organizations and government agencies - the whole compliance and ethics industry itself is barely out of its infancy, though it is growing and progressing rapidly. Monitors fill this void perfectly, often playing the role of teacher and guide to both the organization and government.

I much appreciate Davidoff's dislike that Monitor reports cannot usually be obtained. There are many who argue that Monitor reports, as a general rule, should be publicly available, albeit with appropriate redactions, primarily to protect proprietary, sensitive, and/or personal information that such reports might contain. Also, how willing organizations might be to enter into Agreements where they know a Monitor's reports will be available to the world could have a very chilling impact on both the willingness to enter into such an Agreement and the degree to which the organization might more openly and fully work with a Monitor towards "spiritual compliance."

Balancing the obligation for the Monitor to inform (report to) the government against the risks of such information being used or misused by outside interested parties is a very difficult task, whose consequences could easily outweigh the public interest as it concerns access to a Monitor's reports. For a more recent general exploration of these issues, I suggest "Minding the Monitor: Disclosure of Corporate Monitor Reports to

Third Parties" by Karen Green and Timothy Saunders of Wilmer Hale.

There are a myriad of important issues that still exist around Corporate Monitors that yet need to be pointed out, deliberated, and resolved. I never even touched on "independence," which is certainly one of the big ones! As someone who is passionate about and intimately involved in the development of Standards and "best practices" for Monitors, I hope that writings such as this may bring attention to the important and real Corporate Monitor issues, allay misperceptions, and lead to a greater appreciation for Monitors - an extraordinarily effective and largely under-utilized means by which government and/or other oversight bodies can better achieve long-lasting success in resolving corporate misconduct, fraud, waste, and/or abuse.

If you have thoughts or comments about this topic or anything I have written, please feel free to share them with me: JHanson@ArtificeForensic.com or (202) 590-7702.

About the Author:

John Hanson has over twenty-three (23) years of fraud investigation, forensic accounting, corporate compliance & ethics programs, and audit experience. Much of John's professional experience has been in federal criminal law enforcement, having served for nearly ten (10) years as a Special Agent with the Federal Bureau of Investigation. John has conducted hundreds of investigations involving complex fraud schemes, including Ponzi and Pyramid schemes, embezzlements, money laundering, identity theft, telemarketing fraud, bankruptcy fraud, public corruption, anti-corruption, securities fraud, health care fraud, mortgage fraud, charitable fraud and bank fraud.

John has most recently become known for his contributions, work, and thought leadership in the field of Independent Corporate Monitoring, a practice area involving the imposition of an independent third party by a government agency or department upon a corporation to verify that corporation's compliance with the terms of a settlement agreement. John has previously served in a leadership role in a federal Monitorship and was involved in four other federal monitorships: two as the named Monitor, one as the "Independent Business Ethics Program Evaluator" and the other in support of the named Monitor. In these roles, John has reported to the Department of Justice, the Department of Interior, the Department of Transportation, the Small Business Administration, the Federal Highway Administration and the Massachusetts Department of Transportation. John is also a voting member of the American Bar Association, Criminal Justice Section's Task Force on Corporate Monitor Standards, which is developing Standards and "best practices" for Corporate Monitors.

John is also a Certified Public Accountant (Louisiana), a Certified Fraud Examiner, and a Certified Compliance & Ethics Professional.