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"TRANSPARENCY AND INTEGRITY IN CORPORATE MONITORING"

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Thank you Chairman Cohen, Congressman Franks, Chairman Conyers, Ranking Member Smith, and distinguished Members of the Subcommittee, for the opportunity to testify before you today. I am an associate professor of law at the University of Virginia School of Law. My scholarship focuses on criminal procedure, and I have studied the growing phenomenon of federal organizational prosecution agreements.

Federal prosecutors have adopted a creative and forward-looking approach to corporate prosecutions by entering agreements designed to implement structural reforms while avoiding the potentially dire consequences of an indictment. Attention to these complex agreements is warranted because of the national importance of the cases. This Subcommittee has played a crucial role by examining issues related to the agreements during a time in which there have been a series of important changes in the practices surrounding these agreements. In March 2008, the Department of Justice (DOJ) issued new internal guidelines concerning the selection and use of monitors in organizational prosecution agreements, the "Morford Memo."[1] Those guidelines provide useful guidance and procedures. However, those guidelines do not go far enough. Apparently the DOJ is in the process of reconsidering those guidelines. I am encouraged by the GAO's ongoing work and by the DOJ's ongoing consideration of these issues.

The DOJ's Morford Memo guidelines were drafted following public discussion of the manner in which monitors were selected. Concerns were raised that high profile as well as highly lucrative positions could be awarded as "political plums" to allies or

[1]Craig Morford, Memorandum for Heads of Department Components United States Attorneys, Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations, March 7, 2008 at http://www.justice.gov/dag/morford-useofmonitorsmemo-03072008.pdf ("Morford Memo").

former colleagues. More fundamentally, the question arose as to assurances that the most talented experts were appointed to these complex positions of great public importance.

Monitors serve a crucial function in many of these pre-indictment organizational prosecution agreements. I have gathered and analyzed data concerning these agreements, with the invaluable help of the University of Virginia Law Library.[2] Since the 1990's, but mostly in the past decade, federal prosecutors have entered more than 120 organizational pre-indictment agreements, typically labeled as deferred or non-prosecution agreements. Of those, 48 agreements required the firm to retain an independent monitor. Most agreements also include detailed provisions for the creation or improvement of compliance programs. Monitors are tasked with supervising the implementation of compliance measures, often in very large corporations, and over a period of many months or years. They do not possess duties to shareholders. Nor do they represent the firm or prosecutors. They wield enormous influence and power, particularly where their duties are often broadly defined.[3] Monitors must earn the trust of employees as they assess what solutions are the most effective to prevent recurrence of the misconduct. At the same time, monitors must accurately report to prosecutors.

Despite the importance of these monitors, little can be ascertained about the nature of the monitor selection process or, perhaps more important, the nature and quality of their work. What we can observe from the text of the agreements suggests that organizations often do not play a substantial role in the selection of the monitor. Most

[2] Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853 (2007). The agreements themselves have been posted on a UVA Law Library resource website, together with updated data concerning the agreements. *See* University of Virginia School of Law – Library, http://www.law.virginia.edu/agreements.

[3] *See* Vikramaditya Khanna & Timothy L. Dickinson, The Corporate Monitor: The New Corporate Czar?, 105 Mich. L. Rev. 1713 (2007).

agreements provide that the prosecutor primarily selects the monitor, perhaps with input from the firm. In only a handful of cases, a court selected the monitor. Many of those monitors selected whose names have been made public were former prosecutors. Apart from the text of the agreements themselves, and limited information gleaned from news reports and press releases, much about these cases remains non-public. Given the public importance of their work, a fair process for selection involving public notice and judicial approval is appropriate. I note that guilty plea agreements have received less attention, but they sometimes also require retention of independent monitors.

I have argued that there should be greater attention to transparency in the retention and use of independent monitors in corporate prosecution agreements. I have argued that courts should play a role, although a limited role, in overseeing entry, implementation and termination of these agreements. I have also argued that a judicial role in selecting a monitor would avoid any lingering perception of cronyism in the selection of monitors.[4] A monitor position could be publicly announced, and a judge could select from amongst choices offered by the organization, prosecutor, and any collaborating regulatory agency. I have also argued that greater attention should be paid to evaluating the effectiveness of monitors and compliance reforms. I am glad to see that the GAO is now studying these issues as well.

Today we are focused on a narrower topic, that of conflicts of interest. I will discuss the problem of conflicts. I will then briefly touch on other related matters: selection of monitors, fees charged, scope of duties, transparency and effectiveness.

[4] *See* Written Testimony of Brandon L. Garrett, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, "Deferred Prosecution: Should Corporate Settlement Agreements Be Without Guidelines, March 11, 2008, at http://judiciary.house.gov/hearings/pdf/Garrett080311.pdf; *see also* Garrett, *supra* note 2 at III.B.

Third Party Neutrals

Potential conflicts of interest can be assessed from two perspectives – that of the monitor candidate and that of the prosecutors involved in selecting the monitor. The ethical duties of the monitor, even if she is a lawyer, are limited. After all, as the Morford Memo describes, the monitor is retained by the firm but has no client.[5] The monitor is defined as independent: neither an agent of the firm nor an agent of the prosecutor. The monitor does not provide legal advice. Instead, the monitor serves like a third party neutral. A third-party neutral has an ethical obligation under the ABA Model Rules of Professional Conduct to disclose that they do not represent those they assist.[6]

Proposed additions to the Model Rules would create additional and far more detailed obligations for third-party neutrals. The proposed additions would impose, among other things: a requirement that a third-party neutral maintain confidentiality; an ethical obligation to act "diligently, efficiently and promptly"; an obligation to "decline to serve in those matters in which the lawyer is not competent to serve"; and to be "impartial" as well as to disclose any potential "interests and biases" that might affect impartiality.[7] Some of those subjects may be covered in monitor retention agreements. Monitors are retained and paid by the target firms, and presumably have certain contractual duties, including that of confidentiality. They also have obligations to report to prosecutors. If the monitor reported instead to a court, some problems associated with these poorly defined and non-public obligations could be avoided. Regardless, far more detailed rules are needed to establish the ethical obligations of corporate monitors.

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[5] *See* Morford Memo, *supra* note 1, at 4.

[6] *See* ABA Model Rules of Prof. Conduct, Rule 2.4(b) ("A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them…").

[7] *See* Model Rule for the Lawyer as Third-Party Neutral, 189 PLI/NY 429 (2009) (presenting a proposed Model Rule 4.5 drafted by the Commission on Ethics and Standards in ADR).

Conflicts of Interest

Since the monitor acts as a third-party and does not represent the firm, the most directly applicable ethics rules governing their selection apply to prosecutors. The Morford Memo calls on prosecutors to select highly qualified persons or entities, avoid potential and actual conflicts of interest, and to act so as to "otherwise instill public confidence."[8] On this point, the Memo refers to federal conflict of interest rules, citing to 18 U.S.C. § 208 and 5 C.F.R. 2635. The Morford Memo comment notes that participation by a government personnel that "creates, or appears to create, a potential or actual conflict in violation of 18 U.S.C. § 208 and 5 C.F.R. Part 2635" may result in recusal of those involved in the selection process.[9]

First, 18 U.S.C. § 208 creates penalties for acts of current employees that further financial interests that the current employee has in a proceeding. The section also provides that the employee may not act to further an interest in an organization, particularly with regard to "prospective employment."[10]

Second, 5 C.F.R. §2635 provides a set of general principles concerning conflicts of interest. For example, 2635.101(b) includes prohibitions on obtaining "private gain" and on giving "preferential treatment" to any organization or individual or taking actions providing the "appearance" of doing so.

Those prohibitions do not specifically address employment of former prosecutors. The proposed legislation does address that problem. The existing regulations do bar the appearance of favoritism or providing "preferential treatment," however, which should include the hiring of former colleagues.

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[8] *See* Morford Memo, *supra* note 1, at 3.
[9] *Id.* at 3-4.
[10] 18 U.S.C. § 208(a).

Neither existing rules nor the proposed statute bars the hiring of former prosecutors as monitors, nor should they. A former prosecutor's expertise can provide valuable benefits to both the firm and prosecutors. Nevertheless, prosecutors do not always have the compliance expertise or industry familiarity that can be particularly valuable. Putting potential conflicts to one side, we should be skeptical that a former prosecutor is always necessarily the right choice, particularly a prosecutor who recently left government service and does not have extensive compliance or industry experience. If the monitor is serving in effect as an agent of the prosecutor, then perhaps a former prosecutor fits the intended role. However, agreements contemplate a far broader and more important role for monitors.

Monitors are intended to implement structural reforms. If the monitor is to effectively supervise the creation of an improved compliance program, then strong familiarity with the industry and with implementation and analysis of corporate compliance is a crucial qualification. Monitors should be individuals versed in best practices for implementing particular types of compliance programs. The state of the art for implementing a Foreign Corrupt Practices Act compliance program is very different from the state of the art for implementing a program to prevent securities fraud. Monitors would also benefit from a set of ethical guidelines, together with standards for evaluating efficacy of compliance efforts, and for the accurate and impartial reporting of results. Compliance professionals have developed practices geared towards effective establishment of compliance programs in particular industries. Regulatory agencies may define the compliance practices expected of firms in a particular industry. Both prosecutors and regulatory agencies could promote the dissemination of best practices.

In addition, because these monitors ideally do not serve as agents either of the firm or of the prosecutor, their ethical obligations should be more carefully defined, perhaps along the lines of the proposed Model Rule for Third-Party Neutrals. Corporate monitors have far more complex obligations than many third-party neutrals tasked with evaluating a matter or facilitating a settlement. Monitors should be committed to evenhanded and neutral evaluation of evidence, prompt and impartial reporting of violations to the firm and to the prosecutors or other agencies, and diligent efforts to implement and assess compliance reforms, while adhering to the scope of their retention agreement. One model for an effort to adopt a set of professional standards for monitors is in the organization of Independent Private Sector Inspectors General (IPSIGs).[11]

Selection of Monitors

In its preliminary report, the GAO recommended "that the Deputy Attorney General adopt internal procedures to document both the process used and reasons for monitor selection decisions."[12] The report noted that the DOJ agreed with the recommendation and is considering adoption of such procedures. The internal reforms adopted by the Morford Memo create additional levels of review before a monitor selection is approved. The Memo also recommends that where possible, three candidates should be considered, and if the Government is the primary selecting party, then the corporation should have an opportunity to select a candidate from the pool.[13] Those largely procedural requirements do not, as the GAO noted, provide particularly clear

[11]James B. Jacobs and Ronald Goldstock, Monitors & IPSIGS: Emergence of a New Criminal Justice Role, 43 No. 2 Crim. Law Bulletin 1 (2007).

[12]Statement of Eileen R. Larence, Director Homeland Security and Justice, *Corporate Crime: Preliminary Observations on DOJ's Use and Oversight of Deferred Prosecution and Non-Prosecution Agreements*, June 25, 2009 ("GAO Report").

[13]Morford Memo, *supra* note 1, at 4.

standards for selection of monitors. They do not require that monitor positions be publicly announced so that candidates could apply. Nor do they require documentation of decisions made or reasons for those decisions. The GAO Report concluded that "documenting the reasons for selecting a particular monitor helps avoid the appearance of favoritism and verify that selection processes and practices were followed."[14]

Fees

Another important area for further inquiry is the fees charged by monitors. I take it the GAO is examining this issue.[15] The fee scales of monitors may vary along with their expertise. However, firms may have little recourse should a monitor not exercise sound billing judgment. One advantage of retaining judicial oversight would be to permit a court to periodically review billing.

Scope of Duties

Monitors are often given sweeping "blank check" discretion to gather information, promulgate policies, oversee compliance, and recommend changes to corporate governance. The Morford Memo made clear their role should not be historical, but rather forward looking and geared towards implementing measures to prevent future misconduct. However, these agreements do not always define whether the monitor is to address the specific subject of the initial investigation, or broader compliance concerns.

Transparency and Evaluating Effectiveness

Leaving the scope of a monitor's duties flexible might be less problematic if there was some reason to think that the monitor's work was being carefully evaluated and tailored to the needs of a particular case. Assume that far more comprehensive guidelines

[14]GAO Report, *supra* note 12, at 26.
[15]*Id.* at 28-29.

and procedures are adopted, either by statute or by the DOJ. Unless more about the process surrounding these agreements is made transparent, the public has no way to know whether the new guidelines or procedures are complied with. For example, we have no reason to think that monitors have been retained who formerly worked as a prosecutor on the same matter – but then again, we do not know the names of all monitors appointed, much less how they were selected, how they are paid and how effective they were.

That last concern with effectiveness is particularly troublesome. As it stands, the public cannot tell whether monitoring was ineffectual, achieved the sought after compliance, or was excessive and overly burdensome. Few federal organizational prosecution agreements require, as per the U.S. Sentencing Guidelines, that a compliance program itself be continually and carefully evaluated to assess its effectiveness.[16] As the Guidelines recognize, simply creating a compliance program is not sufficient if none engage in rigorous auditing of the effectiveness of the compliance program. Absent such ongoing assessments, we cannot be confident that a compliance program is not a mere "paper program" that can not effectively prevent a repetition of the misconduct. This is not a hypothetical problem. Last year we had an instance of a repeat violator, a firm that pleaded guilty to a violation of a prior deferred prosecution agreement.[17]

The monitoring process is not transparent, in part for good reason, as confidentiality in many aspects of such work is important. However, it would be reassuring to hear that the DOJ, together with regulatory agencies involved, are assessing

[16] *See* U.S. Sentencing Guidelines § 8B2.1(b)(5) ("The organization shall take reasonable steps--(A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct; (B) to evaluate periodically the effectiveness of the organization's compliance and ethics program.")

[17] *See* Press Release, Aibel Group Ltd. Pleads Guilty to Foreign Bribery and Agrees to Pay $4.2 Million in Criminal Fines ("Aibel Group admitted that it was not in compliance with a deferred prosecution agreement it had entered into with the Justice Department in February 2007 regarding the same underlying conduct."), at http://www.justice.gov/opa/pr/2008/November/08-crm-1041.html.

the work of monitors to develop a set of practices for when monitors are needed and effective. Alternatively, if a court was involved, the judge could periodically evaluate and report on a monitor's progress. The court could solicit view of regulators or compliance experts. The court could intervene to prevent a monitor's term from expiring before the compliance reforms were successfully implemented.[18] The court could similarly intervene to limit the scope of the monitor's action if the monitor was hiring unnecessary staff or performing unnecessary work. Federal courts already supervise similar efforts during organizational probation following a conviction. It is worth considering whether the process could be simplified by involving courts not just in selecting the monitor, but in approving these agreements, and in adjudicating any disputes regarding implementation or a claim of a breach.

Now that independent monitors have assumed a central role in remedying corporate crime, their selection, ethical obligations, professional obligations, together with best practices and the supervision of their work, should all be carefully considered. I hope that this Subcommittee, the GAO and the DOJ continue to examine corporate prosecutions and potential improvements and reforms.

[18] *See* Garrett, *supra* note 2, at III.B.2.