ROLE OF MONITORS IN CORPORATE INVESTIGATIONS AND PROSECUTIONS UPDATE: NEW JUSTICE DEPARTMENT GUIDELINES AND CONTINUING CRITICISM

In response to continuing criticism regarding the use, and potential abuse, of compliance monitors in connection with corporate investigations and prosecutions, the Department of Justice ("DOJ") issued a memorandum on March 7, 2008 setting out guidelines for the "Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations" (the "Guidelines").

The Guidelines effectively curb what had been the nearly unfettered discretion of U.S. Attorneys to demand the appointment of compliance monitors, to influence the appointment of individual monitors, and to direct such monitors' activities. This situation led to the appointment of monitors who had prior political or personal relationships with U.S. Attorneys or other DOJ officials, compensation arrangements imposing millions of dollars in fees on corporations, and demands by monitors that corporate executives resign or be fired. These situations have been widely covered in the media and criticized by Members of Congress, who have introduced legislation that would impose new restrictions on the choice and conduct of monitors.

The Guidelines present nine "principles" that are to be applied to the choice and authority of monitors. DOJ emphasizes that "a monitor's primary responsibility" is to determine whether a corporation is complying with a deferred prosecution or non-prosecution agreement and to "reduce the risk of recurrence of the corporation's misconduct, and not to further punitive goals." This introductory caution appears to be directed at situations in which monitors have attempted to police corporate conduct outside the scope of the underlying agreement. The memo notes that monitors should be used in limited circumstances, such as where there is no effective internal compliance program or where internal controls are lacking, and further directs prosecutors to weigh the benefits of a monitor against the costs.

The Guidelines require that prosecutors notify the appropriate U.S. Attorney or Justice Department Component Head before executing agreements that provide for a monitor. Those officials, in turn, are to provide a copy of the executed agreement to the Assistant Attorney General for the Criminal Division, who is to maintain a record of all such agreements.

The Guidelines' nine basic principles are:

I. Selection of Monitors

1. Process and conflicts. Prosecutors should work together with corporations as early in the selection process as possible to identify the necessary qualifications for the monitor. Monitors must be selected on merit, and the selection process should result in the selection of a "highly qualified and respected person" suitable to the situation. The process should "avoid potential and actual conflicts of interests," and "otherwise instill public confidence." Prosecutors must comply with DOJ conflict-of-interest guidelines in choosing monitors. The Guidelines require that the DOJ

component where the case originated, establish a "standing or *ad hoc* committee . . . to consider monitor candidates," and prohibit U.S. Attorneys and Assistant Attorneys General from making, accepting, or vetoing "the selection of monitor candidates unilaterally." Monitors may not have potentially compromising interests in the monitored corporation or its employees, officers or directors. Corporations must agree not to hire the monitor for at least one year after termination.

II. Scope of Duties

2. Independence. Monitors are independent third parties. They are not employees of the corporation being monitored or the United States government. The Guidelines state that "the monitor is not the corporation's attorney" and should not provide legal advice, but should maintain an "open dialogue" with both the prosecutor and the corporation.

3. Responsibilities. Monitors are to focus on the terms of the agreement that seek to prevent a recurrence of misconduct -- especially terms relating to the proposal and evaluation of internal controls and corporate ethics and compliance programs. Since monitors are "not responsible to the corporation's shareholders," they should provide "input, evaluation, and recommendations," but should not design the actual programs.

4. Scope of monitoring authority. Monitors are to focus on the misconduct addressed in the agreement. A monitor may use the established record of historical misconduct "to inform" an "evaluation of the effectiveness" of corporate compliance with an agreement, but should not "investigate historical misconduct."

5. Reports. Monitors should communicate freely with both the corporation and the government. This may include sending periodic written reports to both parties on monitoring activities, compliance with the agreement, and recommendations for changes to enhance compliance.

6. Corporate response. Monitors should report corporate decisions not to adopt the monitor's recommendations, and the corporation's reasons therefor, to the government. Such decisions may be considered when the prosecutor evaluates whether the corporation has fulfilled its obligations under the agreement. Monitors' recommendations and corporate responses should be reported "well before the expiration of the agreement."

7. Reporting misconduct. Agreements should specify the types of undisclosed or new misconduct that monitors are to report to the government, and give the monitor discretion to report other misconduct to the corporation or the government or both. If the misconduct poses a risk to public health or safety, involves senior management, obstruction of justice, or possible criminal activity that the government "has the opportunity to investigate proactively and/or covertly," or "otherwise poses a substantial risk of harm," the monitor generally should choose to report it only to the government and not to the corporation.

III. Duration

8. Length of agreement. The duration of the agreement should be based on the nature, seriousness, duration, and pervasiveness of the misconduct, the involvement of senior management, the history

(if any) of similar misconduct, "the corporate culture," the "scale and complexity of remedial measures," the size of the business, and the state of remedial action when the monitor is appointed.

9. <u>Extension or early termination</u>. The agreement should allow for the government to extend the monitoring period if the corporation has not fulfilled its responsibilities under the agreement, or for an early termination if, for example, the corporation can show the government that it has "ceased operations" or has been acquired by an entity that "has an effective ethics and compliance program."

While the Guidelines do restrict significantly the authority of both U.S. Attorneys and monitors, they do not require any real uniformity in agreements or monitor selection, approval by top DOJ officials, or any court review of agreements or monitors. As a result, Members of Congress who have been most critical of DOJ have called the Guidelines inadequate and stated that they will continue to press for legislation. However, at a hearing of the Judiciary Committee of the U.S. House of Representatives on March 11, Democratic leaders of the Committee said that they intend to continue investigating the monitor issue but stopped short of endorsing new legislation. At the same hearing, a number of legal scholars and former DOJ officials recommended DOJ approval, judicial review, and the development of more specific criteria and procedures for monitor selection.

This issue remains controversial, and actions to date increase pressures on prosecutors to act with greater care in drafting agreements and in choosing and supervising monitors. These actions, in turn, strengthen the ability of corporations potentially subject to such agreements to limit their scope as well as the resulting responsibilities and authority of monitors.

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March 17, 2008

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