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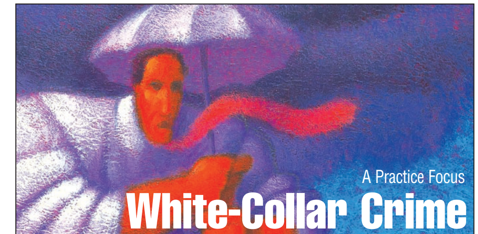
No Need for a Monitor

You can persuade the government not to require another set of eyes.



By David S. Krakoff
and James T. Parkinson

Resolving Foreign Corrupt Practices Act violations with the Department of Justice and the Securities and Exchange Commission used to mean just that: resolution. With a resolution came relative peace. Chastened by the investigation and enforcement action, a company could heal its wounds and proceed. Those days are long gone.

Now, when a company "resolves" a matter—with a plea agreement, SEC settlement, press statements, monetary sanctions, and potential parallel civil litigation—there will almost certainly be years of compliance and possibly additional enforcement actions. More and more, these actions will be driven by the presence of a so-called independent monitor. In almost every recent corporate FCPA settlement, the government has required imposition of a monitor.

Moreover, the growing interest in monitors is not limited to the FCPA context, and these corporate overseers do not simply bide their time. In September 2006, the independent monitor for Bristol Myers-Squibb Co., who was installed pursuant to a deferred prosecution agreement, recommended that the board fire the CEO, which it did.

Although monitors have become nearly a certainty, critical lessons may be drawn from one recent FCPA matter that was resolved without one.

A Powerful Intrusion

What is a standard feature of corporate enforcement today started as a trend in the mid-1990s. Monitors initially arose in the context of deferred prosecution agreements, where a company seeking to avoid indictment might view a monitor as a sensible concession. Enron and other scandals led to sanction creep, and now authorities frequently insist on a monitor as a precondition to settlement.

Monitors introduce the discomfiting presence of enforcement authority into the corporate suite. Though formally independent, the monitor is an instrument of the government possessing free rein to interview employees, review documents, and opine on the strength or weakness of internal compliance programs.

The basic parameters of a monitor's engagement are similar from case to case. A monitor selected by the company must be approved by the government—a process that tends to encourage retention of former enforcement officials well-known to current staff. The period of engagement is typically two or three years, so the company has to live with the monitor through several public reporting cycles and management certifications. Expenses, which are borne by the company, quickly run into the millions. Standard retention papers provide that no attorney-client relationship exists between the corporation and the monitor, creating knotty privilege issues for the corporation seeking to defend itself in any parallel litigation.

Given these costs and concerns, the example of one recent FCPA matter that settled without a monitor could prove useful. In February 2007, the SEC approved a settlement with Dow Chemical Co. related to conduct at a fifth-tier subsidiary. In its complaint, the SEC set forth corporate conduct that it took into account when weighing a penalty:

"Dow conducted an internal investigation . . . and, upon its completion, voluntarily approached Commission staff and presented the results. Dow also undertook certain remedial actions, . . . including employee disciplinary actions. Dow retained an independent auditor to conduct a forensic audit of the books and records and internal controls; . . . reported its internal investigation to the Audit Committee of the Board of Directors; and provided FCPA compliance training. . . . In addition to the remedial actions relating to [the subsidiary], Dow restructured its global compliance program; improved and expanded FCPA compliance training for employees of Dow and its subsidiaries worldwide; trained its internal auditors to recognize FCPA issues; and joined a non-profit association specializing in anti-bribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations and provides

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FCPA training to them. Dow also hired an independent consultant to review and assess its FCPA compliance program."

While cases differ, and some inevitably present facts where a monitor cannot be avoided, the Dow Chemical settlement offers benchmarks for other companies seeking to avoid a monitor.

Practice Tips

In the early stages of an investigation, counsel and management face dozens of consequential decisions. A few stand out as particularly important to the issue of monitors.

Disclosing voluntarily. When the problem first comes to management's attention, the determinative initial decision is whether to make a voluntary disclosure to enforcement authorities. Many sound reasons exist for declining to disclose. If the primary corporate goal is to avoid a monitor, however, a voluntary disclosure is essential.

Investigating thoroughly. Equally importantly, counsel must establish the integrity of management in the eyes of the government. The primary means is by establishing the credibility of the internal investigation, which authorities will carefully examine.

The investigation must be of a scope and depth sufficient to root out misconduct. The government must be convinced of this scope and depth; if authorities do not credit the investigation's findings and do not view management as the right team to run the company after a settlement, a monitor will surely be deemed necessary. Thus, differentiating the management team going forward from the participants in the underlying conduct is also critical. And, as management's mouthpiece, outside counsel must be viewed as even-handed and candid.

Two major mistakes are delay or artfulness in the remediation, which the government may interpret as management's lack of commitment to compliance. Lack of transparency in the investigation may foster the same governmental unease.

Pursuing real remediation. Aggressive remedial measures must be taken and documented. Merely terminating the employees who acted improperly will not be enough. Managers all the way up the corporate ladder must be disciplined, even those who were not personally involved or had no direct knowledge of the wrongdoing. Turning a blind eye or failing to supervise cannot be an excuse—the company must demonstrate that it holds management to a high standard. This is particularly important in the FCPA context, where the misconduct often occurred in some lower-tier foreign subsidiary or joint venture. Demonstrating that compliance is required from the top down is essential.

Counsel must also examine the company's compliance and internal controls programs to determine whether they could be strengthened to prevent a recurrence. Such changes demonstrate the company's willingness to look at the institution overall as well as to address narrow, conduct-specific problems.

Providing information. Unfortunately, cooperation creep (the counterpart to sanction creep) has implicitly put waiver of the attorney-client privilege on the table every time. Enforcement authorities expect the idea of waiver to be raised early in the process of cooperation, and counsel must decide quickly what to do. The larger debate over the McNulty memorandum aside, companies may well choose to provide enough factual information to allow the government to fully understand the matter.

Avoiding a monitor may turn on how successful counsel is in reducing the government's need to investigate. In other words, has counsel done a full inquiry and made those results available?

To shield the company in collateral litigation, the preferred means of sharing information are providing oral briefings and permitting government lawyers to read interview memos and notes in counsel's office. Of course, if the government is not satisfied with this approach, counsel may have to be more flexible with the mechanics of the disclosure.

Doing the work. Finally, counsel must anticipate the government's requests and objectives and demonstrate that the company has already performed any work that a monitor would do. The government imposes a monitor where it sees a failure of compliance programs and believes that the monitor can remedy that failure and prevent future problems. A company that is already performing the potential monitor's work can argue that a monitor is superfluous.

As noted, compliance and internal controls programs must be rigorously evaluated and all weaknesses remedied. An outside accounting firm should be engaged to bring independence and expertise to the analysis of the books, records, and internal controls. That ensuing report may be disclosed to the government. The corporation may even engage an independent consultant to assess and improve compliance mechanisms beyond FCPA standards.

The trend is clear: Corporations seeking resolution of enforcement matters more often find themselves saddled with independent monitors. While some might "find the medicine worse than the malady," there are concrete steps that counsel can take to reduce the likelihood of a monitor being imposed. The best argument for preventing a monitor is that the problem is already cured.

David S. Krakoff is a partner and James T. Parkinson is an associate in the white-collar defense and compliance practice in the D.C. office of Mayer, Brown, Rowe & Maw. The firm represented Dow Chemical in the case discussed. The authors can be contacted at dkrakoff@mayerbrownrowe.com and jparkinson@mayerbrownrowe.com.

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