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Monitoring the Monitor?: The Need for Further Guidance Governing Corporate Monitors Under Pre-Trial Diversion Agreements

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Over the last several years, there has been an increase in federal prosecutors' use of Deferred Prosecution Agreements (''DPAs'') or, in some cases, Non-Prosecution Agreements (''NPAs'').

From 2002-2005, the Department of Justice (''DOJ'') entered into twice as many of these agreements with defendant-companies as it had over the previous 10 years. Between 2005 and 2007, the number of these agreements increased even more with approximately 12 in 2005, 20 in 2006, and 30 in 2007.[1] In 2008, according to a recent study, the number of these agreements decreased to 16, a near 60 percent drop from 2007.[2] It is unclear whether the number of these agreements will increase under the Obama Administration. Nevertheless, pretrial diversion agreements remain a tool that U.S. attorneys' offices may wield to fight corporate corruption without otherwise requiring a company to plead (or to be found) guilty of a criminal action.

Yet, the use of pretrial diversion agreements has been controversial in many aspects and raises a host of questions about procedural fairness and the criminal justice system.

DPAs and NPAs are two types of pretrial diversion agreements that may be entered into by the government and a defendant-company. The main difference between a DPA and an NPA is that charges are not filed in the latter; however, the obligations imposed in both types of agreements are extensive.[3]

Generally, DPAs/NPAs involve a filing of a criminal charge, admission of criminal wrongdoing and to the facts in the charging instrument, substantial monetary penalties, adoption of strict corporate governance and compliance programs, cooperation with the government's ongoing investigation, and an agreement to ex-

[1] Lawrence D. Finder & Ryan D. McConnell, *Annual Corporate Pre-Trial Agreement Update—2007*, 22nd National Institute on White Collar Crime (March 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1080263.

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[2] Lawrence D. Finder & Ryan D. McConnell, *Betting the Corporation: Compliance or Defiance? Compliance Programs in the Context of Deferred and Non-Prosecution Agreements—Corporate Pre-Trial Agreement Update–2008*, (forthcoming 2009 in the Corp. Counsel Rev.—Published by S. Tex. College of Law, Volume XXVIII, No.1) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1332033.

[3] For ease of reference, the authors refer in this article to pretrial diversion agreements collectively as ''DPAs/NPAs'' or in the singular as ''DPA/NPA.''

 ISSN 1092-1079

ternal oversight by a corporate monitor approved by the government.

If the company abides by the terms of the DPA/NPA, then the company will avoid prosecution.

DPAs/NPAs are a method for federal prosecutors to impose penalties and internal reforms on companies without subjecting them to the dire consequences of a criminal conviction.

A health system, for example, if convicted criminally, can be excluded from future participation in federal health care programs, such as Medicare and Medicaid. This is devastating not only to the health system, itself, but also to the community of patients that rely on the health system for health care services.

A key and controversial element in many DPAs/NPAs is their reliance on a corporate monitor who is responsible for overseeing the company's compliance with the requirements memorialized in the agreement, itself, and generally the company's compliance with law.[4]

Usually, these pretrial diversion agreements require the company to retain the monitor at the company's expense. Although the number of DPAs/NPAs decreased by nearly 60 percent in 2008, the percent of agreements that contain monitor provisions has remained constant at 40 percent in 2007 and 2008.[5]

Despite the amount of ink that has been spilled over DPAs/NPAs, there exists little guidance that defines the role of corporate monitors. This is troublesome because monitor provisions often grant virtually unfettered authority, compensation, and discretion to the monitors. In 2008, the DOJ issued guidance to U.S. attorneys' offices in this area.[6]

However, that internal guidance—commonly referred to as the Morford Memo—left many questions unaddressed. Examples of these questions include: how a person/entity becomes eligible to serve as a corporate monitor, should monitors be subject to any ethical rules or guidelines, who should be responsible for overseeing the monitor's actions, do monitors have too much authority over business and corporate governance decisions, are prosecutors ill-equipped to oversee the monitor's decisions, and to whom should the company address any potential grievances it has with the conduct of a monitor.

Subsequent to the Morford Memo, the DOJ issued additional guidance concerning ''extraordinary restitution'' in DPAs/NPAs, and amended the Principles of Prosecution of Business Organizations to address attorney-client and work product privileges in connection with DPAs/NPAs.[7] The DOJ has not issued any further guidance since the Morford Memo that addresses corporate monitors.

As the 111th Congress begins its session and the Obama administration takes charge of the Executive Branch, the time is ripe for the Executive Branch to develop further guidance to U.S. attorneys' offices about the roles, responsibilities, and duties of corporate monitors.

I. Corporate Monitor Provisions in Pre-Trial Diversion Agreements

Background

The Federal Sentencing Guidelines require probation if a company fails to have a mandatory compliance and ethics program in place at the time of sentencing.[8] Probation requires companies, among other things, to submit to a reasonable number of examinations of their books and records by an officer appointed by the court.[9] Over the years, a series of DOJ memoranda applied the corporate probation model to the charging stage of a corporate prosecution. In particular, the Principles of Federal Prosecution of Business Organizations—commonly referred to as the Thompson Memo—explicitly stated that ''pretrial diversion may be considered in the course of the government's investigation.''[10] This opened the door for modern day DPAs/NPAs.

Generally, about 40 percent of DPAs/NPAs include a corporate monitor requirement that enforce a method of oversight similar to corporate probation during the charging phase of a prosecution.

For example, in a 2005 DPA, Bristol-Myers Squibb (''BMS'') agreed that it would ''retain an outside, independent individual or entity (the ''Monitor''), selected by BMS and approved by the [U.S. Attorney's Office for the District of New Jersey]'' and that, among other things, the Monitor was to ''[m]onitor BMS's compliance with [the DPA] Agreement, and have authority to require BMS to take any steps he believes are necessary to comply with the terms of [the] Agreement.''[11]

The vast majority of monitors come from the ranks of former judges, prosecutors, or Securities lawyers. It is unclear, however, whether the monitor must be an attorney, or whether other qualified professionals—such as accountants, professors, or consultants—could serve as monitors, as well.

Concerning the selection process for monitors, both prosecutors and the company must mutually agree to the selection. Sometimes prosecutors suggest a list of particular monitors. At other times, the company may

[4] DPAs/NPAs use a variety of terms to describe the role referred to in this article as ''monitor'' or ''corporate monitor'' (e.g., advisor, independent monitor, and examiner).

[5] Lawrence D. Finder & Ryan D. McConnell, *Betting the Corporation: Compliance or Defiance? Compliance Programs in the Context of Deferred and Non-Prosecution Agreements – Corporate Pre-Trial Agreement Update – 2008*, (forthcoming 2009 in the Corp. Counsel Rev.—Published by S. Tex. College of Law, Volume XXVIII, No.1) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1332033 at 11.

[6] Available at http://www.usdoj.gov/dag/morford-useofmonitorsmemo-03072008.pdf

[7] Memorandum from Mark Filip, Deputy Attorney General, to Holders of the U.S. Attorneys Manual (May 14, 2008); Remarks as Delivered by Deputy Attorney General Mark R. Filip at American Bar Association Securities Fraud Conference (Oct. 2, 2008) *available at* http://www.justice.gov/archive/dag/speeches/2008/dag-speech-0810022.html.

[8] *U.S. Sentencing Guidelines Manual* § 8D1.1(a)(3).

[9] Id. at § 8D1.4(c)(4).

[10] Memorandum from Larry D. Thompson, Deputy Attorney General, to the Heads of Dep't Components, U.S. Attorneys, Section VI (B) (Jan. 20, 2003).

[11] See http://www.law.virginia.edu/html/librarysite/garrett_bycompany.htm (follow Bristol-Myers link). This library collection contains scanned links to pretrial diversion agreements. Created by Professors Brandon Garrett and Jon Ashley of the University of Virginia Law School, the library is an excellent resource for research about DPAs/NPAs. It provides links to every agreement referenced in this article.

  HFRA ISSN 1092-1079

choose the monitor while prosecutors retain a veto power over its choice.

Undeniably, though, despite the Morford Memo, prosecutors hold tremendous bargaining power in the selection of a monitor because of the consequences that could be triggered from a company's non-compliance.

What Are the Roles, Responsibilities, and Duties of the Monitor?

Generally, monitors are tasked in the agreement with collecting information and preparing reports to assist the prosecutor in determining whether the company has abided by the DPA/NPA.

Monitors hold the power to review the company's compliance with its obligations under the agreement, and under laws generally, and to issue reports to the government and/or to the court. More specifically, monitors review and test the company's accounting, information management, and internal control functions.

Once a DPA/NPA is in place, a monitor begins by becoming familiar with the company. This entails meeting the company's board and employees. A monitor then develops a work plan that defines the scope, access, and power the monitor will have over the company. The monitor's work involves frequent visits to the company (including possible on-site accommodations) and broad access to company documents and meetings.

The monitor should be knowledgeable about the regulatory aspects of the company's operations, but that is not necessarily a criterion for selection of the monitor. Indeed, a monitor can hire others to assist in his or her responsibilities at the company's expense.

The monitor files periodic reports with the U.S. attorney's office and makes visits with that office as well as with the company. At the conclusion of a monitor's term—often 24-36 months—the monitor files a final report that details the activities accomplished and whether the company complied with all the terms of the agreement.

Many DPAs/NPAs grant wide-ranging, and in some circumstances ill-defined, responsibilities and powers to the monitor. For example, in 2005, the U.S. Attorney's Office for the District of New Jersey entered into a DPA with Bristol-Myers Squibb in connection with allegations regarding securities fraud. The monitor, former Judge Frederick Lacey, was given the power to ''take any steps he believes are necessary to comply with the terms of [the DPA].''

In another example, again in 2005, KPMG entered into a DPA related to charges of tax fraud. Here, the monitor was tasked with the responsibility of reviewing, monitoring, and making recommendations concerning: compliance with the DPA, KPMG's Compliance and Ethics Program, personnel decisions regarding individuals who engaged in the illegal conduct, and various limitations placed on KPMG and its continued tax practice.

To that end, the DPA stated that it was the intent that the monitor's jurisdiction, powers, and oversight authority and duties be broadly construed. This is reflected in Paragraph 18(a), which states that ''KPMG shall adopt all recommendations submitted by the Monitor unless KPMG objects . . . and the [USAO] agrees. . . .''

The monitor also has the ''authority to take . . . actions . . . necessary to effectuate . . . oversight and monitoring provisions.'' Furthermore, the terms of the KPMG DPA allow the monitor to recommend dismissal or other disciplinary action of any KPMG employee if that employee fails to cooperate.

The DPA entered into by the University of Medicine and Dentistry of New Jersey (''UMDNJ'') with the U.S. Attorneys Office for the District of New Jersey contains one of the most extensive grants of power to a monitor in a health care fraud case. This three year DPA was entered into in 2005 and specifically authorized the corporate monitor to:

- Conduct a nationwide search for a new General Counsel and Chief Compliance Officer and provide options to the Board of Trustees;
- Perform a comprehensive review of all policies, procedures and report findings and recommendations to the Board of Trustees on a variety of issues (e.g., corporate structure, effectiveness of legal, finance, audit, compliance and audit functions, third party cost reporting and billing, relationship with faculty practice plan, and conflicts of interest);
- Review employment practices and make recommendations to the Board of Trustees on hiring and firings of senior management and legal, finance, and compliance personnel; and
- Review and give approval to the hiring and firing of all outside counsel.

The three DPAs discussed above granted each monitor vast amounts of authority over defendant-companies. Although not all DPAs give monitors such authority, these three agreements are examples that highlight the need for further guidance as to how corporate monitors should exercise this broad contractual authority.

II. Previous Calls and Attempts at Defining the Corporate Monitor

Both the U.S. Congress and the DOJ have taken steps to implement reforms concerning monitors. On the congressional side, in March 2008, the House Judiciary Subcommittee on Commercial and Administrative Law held hearings regarding the selection of corporate monitors and issues related to the terms that govern corporate monitors.

In his Opening Statement to the hearing, Rep. John Conyers Jr. (D-Mich.) stated that there are several reasons additional oversight is needed, including ensuring transparency and consistency, and perhaps most importantly, to eliminate any ''politicization'':

One such example of the potential for politicization has arisen in the agreement between Zimmer Holdings and the U.S. Attorney's Office for the District of New Jersey, in which U.S. Attorney Christopher Christie chose his former supervisor, namely, former Attorney General John D. Ashcroft, as the corporate monitor. Pursuant to this agreement, Zimmer Holdings has agreed to pay Mr. Ashcroft's firm anywhere from $28 million to $52 million. Prior to Mr. Ashcroft's appointment, however, there was neither public notice of the monitor position nor any public bidding for the assignment.[12]

During the 110th Congress, Reps. William J. Pascrell Jr. (D-N.J.), along with Reps. Frank Pallone Jr. (D-N.J.),

[12] See http://judiciary.house.gov/hearings/pdf/0311082opening.pdf

Linda T. Sanchez (D-Calif.), and Conyers introduced H.R. 6492, titled ''Accountability in Deferred Prosecution Act of 2008,'' setting forth certain requirements regulating the process by which the DOJ allows U.S. attorneys to engage in DPAs/NPAs with corporate offenders and award corporate monitoring contracts.

The legislation was deferred in light of the DOJ's issuance of guidance. However, the House and Senate have tasked the Government Accountability Office (''GAO'') to issue a report examining federal monitor provisions in pretrial diversion agreements. At the time of this publication, this report has not yet been issued. GAO said the Report may be released to the House Judiciary Committee in September 2009.

From the administrative/executive side, immediately preceding the congressional hearing discussed above, the Morford Memo outlined various principles to be considered by the DOJ when negotiating and finalizing monitor provisions. The principles discussed in the memorandum are as follows:

Selection of Monitor

■ Before the monitor is selected, the corporation and Government are to ''discuss the necessary qualifications for a monitor based on the facts and circumstances of the case.''

■ The monitor must be selected based on merits and the selection process should be designed to ''(1) select a highly qualified and respected person or entity based on suitability for the assignment and all of the circumstances; (2) avoid potential and actual conflicts of interests, and (3) otherwise instill public confidence. . . . ''

■ To avoid conflicts of interests, this principle sets out that: (1) Government attorneys participating in the selection of a monitor must be mindful of the government's conflict-of-interest guidelines; (2) there should be a committee in the Department component or office where the case originated to consider monitor candidates; (3) the Office of the Deputy Attorney General must approve the monitor; (4) the Government should decline to accept a monitor if he or she has ''an interest in, or relationship with, the corporation or its employees, officers or directors that would cause a reasonable person to question the monitor's impartiality'' and (5) the ''Government should obtain a commitment from the corporation that it will not employ or be affiliated with the monitor for a period of not less than one year from the date the monitorship is terminated.''

Scope of Duties

■ ''A monitor [should be] an independent third-party, not an employee or agent of the corporation or of the Government.''

■ A monitor's primary responsibility should be to assess and monitor a corporation's compliance with the DPA and those provisions that are designed to address and reduce the risk of recurrence of the corporation's misconduct.

■ ''[A] monitor will often need to understand the full scope of the corporation's misconduct covered by the agreement, but the monitor's responsibilities should be no broader than necessary to address and reduce the risk of recurrence of the corporation's misconduct.''

■ ''Communication among the Government, the corporation and the monitor is in the interest of all the parties . . . [and] it may be appropriate for the monitor to make periodic written reports to both the Government and the corporation.''

■ If the corporation does not adopt recommendations made by the monitor within a reasonable time, either the monitor or the corporation, or both, should report that fact to the Government, along with the corporation's reasons. The Government may consider this conduct when evaluating whether the corporation has fulfilled its obligations under the agreement.

■ The DPA should ''clearly identify any types of previously undisclosed or new misconduct that the monitor will be required to report directly to the Government'' and that as to evidence of other such misconduct, ''the monitor will have the discretion to report this misconduct to the Government or the corporation or both.''

Duration

■ ''The duration of the agreement should be tailored to the problems that have been found to exist and the types of remedial measures needed for the monitor to satisfy his or her mandate.''

■ ''In most cases, [the DPA] should provide for an extension of the monitor provision(s) at the discretion of the Government in the event that the corporation has not successfully satisfied its obligations under the agreement. Conversely, in most cases, an agreement should provide for early termination if the corporation can demonstrate to the Government that there exists a change in circumstances sufficient to eliminate the need for a monitor.''

Duration of Agreement

The Morford Memo provides that the following criteria should be considered when determining the agreement's duration: ''(1) the nature and seriousness of the underlying misconduct; (2) the pervasiveness and duration of misconduct within the corporation . . .; (3) the corporation's history of similar misconduct; (4) the nature of the corporate culture; (5) the scale and complexity of any remedial measures contemplated by the agreement . . .; and (6) the stage of design and implementation of remedial measures when the monitorship commences.''

Flexibility of Monitor's Term

The Morford Memo recommends flexibility in the monitor's term to allow, at the Government's discretion, both an extension of the monitor's term in the event that the company has not satisfied its obligations under the agreement, as well as early termination of the monitor if there exists a change in circumstances sufficient to eliminate the need for a monitor.

We believe that this type of contractual flexibility may only work in favor for the Government. This is because the parties could agree to a reduced time period, then the agreement could then be amended—e.g., abandonment of the product line, etc., but there needs to be a firm and specific deadline for these agreements. Otherwise, the government threat of prosecution has no end.

If the government is not ''satisfied'' that the company has met its DPA/NPA obligations, the agreements provide for a breach and procedures related to that. Recognizing that a breach may require a higher standard of non-compliance, the U.S. attorney has several opportunities throughout the term of the agreement to make it known that he or she may not be fully satisfied with the

   ISSN 1092-1079

company's performance even in the absence of conduct that could constitute a breach.

III. Recommendations for Areas Requiring Further Guidance

As a threshold issue, DPAs/NPAs raise a number of questions about procedural fairness and the criminal justice system. However, they remain a tool used by some U.S. attorney's offices. Consequently, DPAs/NPAs, if used, should be drafted carefully to reduce the need for interpretation. They should clearly define the roles of the parties, expectations regarding privilege, termination date of the agreement, and shareholder liability issues.

Yet, a carefully drafted DPA/NPA may not eliminate the need for further guidance implemented either by Congress and/or by the DOJ. The guidance discussed below could ensure, as justice requires, the appropriate balance between serving the public interest and the need for the appropriate punishment, while respecting the rights of individuals and companies to appropriate due process.

Judicial Oversight

One of the many guidelines that emerged from the Morford Memo was the requirement that a monitor be approved by the Office of the Deputy Attorney General. This is an important step in defining the scope of a monitor's role and power because it provides an additional level of accountability within the DOJ.

For purposes of due process protections, there may need to be a greater role for the judiciary in DPAs/NPAs in an attempt to separate the function of prosecutor and judge when it comes to compliance. For example, if a monitor's recommendation is declined, many current DPAs/NPAs, as well as the Morford Memo, set forth that the company can ''appeal'' this recommendation to the U.S. attorney's office.

However, given that the U.S. attorney is serving as both the ''judge'' as well as prosecutor, it seems inevitable that failure to follow a recommendation of the monitor could be construed by the U.S. attorney as noncooperation and potentially a breach of the DPA/NPA.

Should the judiciary play a greater role to help as a check and balance in ''monitoring the monitors''? Can the judiciary play such a role?

For example, the Boeing DPA has a provision that requires a judge to settle questions regarding breach. Could or should this provision be negotiated or required by the DOJ through additional guidance or by legislation? In the absence of charges being brought, what would be the nexus with the judiciary? This key provision would allow the judge to use a monitor's advice and guidance in determining whether a breach has occurred, and would emphasize the unbiased role of the monitor in reforming the defendant-company.

A possible guidance could be provisions that grant the judiciary greater monitoring responsibilities over monitors that have more power to manage the company (e.g., BMS DPA), while leaving the DOJ with greater oversight over monitors that are more comparable to advisors (e.g., Computer Associates DPA).

Conflict of Interest

Although the Morford Memo references the issue of conflicts of interest that may arise in connection with the selection of a monitor and the monitor's relationship with the corporation, a number of conflicts of interest questions remain unanswered.

For example, should an attorney, who is a monitor for one company, also defend another company before the same U.S. attorney's office during the monitoring period? If the answer to that question is ''no,'' then does this conflict apply not only to the individual person serving as the monitor, but also to the attorney's entire law firm?

There should be a more detailed set of rules governing conflicts for corporate monitors similar to the development of conflict of interest rules related to attorneys in private practice, government attorneys, and judges.

A related issue involves providing guidelines to the monitors, themselves. Currently, for example, no guidance exists—except in very broad terms—explaining the content that should be included in a monitor's final report. This lack of guidance could leave monitors defenseless if shareholders of the defendant-company hold them liable for misstatements made in their reports or in their actions as monitors.

Ensuring the Expertise and Consistency of Corporate Monitors

While there obviously is need for flexibility in determining who should serve as a monitor based upon the industry and the extent of the monitor's responsibilities, more detailed guidelines should be established about the minimum level of expertise a monitor must possess.

Also, a central clearinghouse for monitor-related activities might help as an informal exchange of information among monitors to take advantage of the knowledge of monitors, themselves, in developing consistency in approach and in encouraging best practices. It could serve as an informal way to achieve some type of standardization or consistency of treatment and activities across multiple monitors.

Regulating Fees

With respect to fees, while there may be variations in the agreements as to the resources required due to the responsibilities imposed on the monitors and the size of the organization, some standards should be established as to the reasonableness of fees and expenses imposed by monitors on the defendant-companies.

Coordinating Corporate Integrity Agreements & Deferred Prosecution Agreements

To the extent a company also will be subject to other corporate integrity obligations—such as a Corporate Integrity Agreement (''CIA'') with the Department of Health and Human Services Office of Inspector General—these multiple agreements should be considered in their totality in light of their respective terms and any potential redundancies.

For example, both the Zimmer DPA and CIA were signed on Sept. 27, 2007, although some of the CIA provisions, like independent reviews, do not begin until after the DPA monitor term is completed.

If the monitor finds the company compliant for the initial periods, then perhaps the CIA obligations should be modified (e.g. time period shortened, IRO review reduced), especially since the monitor's involvement with

the company is significantly more involved than under a CIA.

Also, the procedures established to the satisfaction of the monitor should be sufficient for integrity obligations in the CIA covering the same or similar topics.

IV. Conclusion

Pre-trial diversion agreements are a relatively new method for addressing corporate noncompliant conduct. Both the enforcement agencies and the corporate defense bar benefited from the DOJ guidance issued in 2008. However, important questions remain unanswered, and all would benefit from further guidance.

  HFRA ISSN 1092-1079