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Corporate Monitors

Taking Corporate Cooperation to the Next Level

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In the wake of corporate scandals and high-profile prosecutions, many companies have avoided prosecution or have otherwise negotiated reduced sanctions in recent years by cooperating with prosecutors or regulators and entering into agreements that often include accepting a monitor. The monitor generally continues to investigate and proposes further changes where appropriate, reporting directly to the government at the company's expense.

The government sees installing a monitor as a way to ensure that the company does more than simply pay a fine and move on. The practical effect is that the company continues to some extent to be under investigation, even after the settlement. By imposing a monitor, the government keeps tabs on the company and tries to make sure it deserves the concessions it has received.

While life under monitorship can be onerous, it can also be beneficial and is often the company's best option under the circumstances. In this article, we discuss what happens during monitoring, what to look for in a prospective monitor, and how to make the most of a monitorship.

What Is a Monitor?

In years past, a company facing serious investigation would almost reflexively argue that it and its employees did not break the law. Those days, for the most part, are gone. Now, companies often admit to wrongdoing early on, and then turn over the fruits of their in-depth internal investigations to the government. The next step for the company often is accepting a deferred prosecution, pleading guilty, or otherwise settling. More and more often, such settlements require that a monitor be installed.

Monitors are often lawyers. They are governed by a written monitoring agreement that lays out the rights and obligations of all involved, as well as the consequences of noncompliance. Such agreements typically last three to five years, and sometimes allow for early termination as a reward for superior compliance. The agreements grant the monitor broad authority and discretion in reviewing the company's books and records; interviewing employees, suppliers, vendors, and customers; evaluating compliance with local, state, federal, and international laws; and proposing or requiring changes.

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The government will expect the monitor to continue its investigation of wrongdoing and to look further, often both in the area that was the subject of the original investigation and more broadly. To this end, the monitor often will bring in forensic accountants to assist in reviewing the company's accounting and other records, and to flush out any irregularities or evidence of noncompliance.

The forensic accountants will perform forensic analysis that is more targeted and detailed than the financial statement audits performed by the company's audit firm. The forensic audit team working with the monitor must be able to work objectively, in both fact and appearance. The forensic accountants will work closely with the monitor, especially if the conduct that led to the monitorship dealt with domestic or international bribery, or accounting or financial statement issues. They will advise the monitor in determining the scope of the review and what specific steps should be taken to review current policies, procedures, and practices.

Although a good monitor endeavors to communicate well and coordinate with the company whenever possible, the monitoring agreement will make plain that the monitor reports to the government in the first instance. That means that the company may well not have complete information about exactly what investigative avenues the monitor is pursuing. It also bears noting that the monitor is not in place to protect the company or its privileges, and is expected to share any significant findings with prosecutors and regulators.

Making the Most of Monitorship

When a company is in a position to agree to a monitorship, it is likely in a precarious situation. The government's investigation is likely well advanced, and the company may be on the brink of indictment or other serious adverse action. Shareholders may be looking to divest or may have already sued. Customers may be questioning the company's product or services, threatening market share. Finally, the company may be looking at taking a significant financial hit, or its viability may be in question altogether.

Given these circumstances, the benefits of a monitorship to the company can be immeasurable. By agreeing to accept a monitor, the company avails itself of an alternative to sanctions that could cripple the company, or even put it out of business. But the company should go in with its eyes open, and understand that a monitor is not a trivial add-on term to the negotiations.

In the end, the value the company can realize from a monitor's involvement depends in large part on the agreement's structure and the company's approach to the process. With this in mind, we offer five practical suggestions.

One: Carefully Negotiate the Monitoring Agreement

The monitorship agreement should be the product of careful drafting and will be a constant reference point throughout. It is important to render the agreement as specific as possible to avoid costly disputes later. A primary

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focus in negotiating the monitoring agreement is its scope. It is essential to clearly delineate the breadth of the monitor's inquiry. For example, is the inquiry prospective only, or is the monitor entitled to explore facts predating the monitorship? Are certain areas of the company or its subsidiaries, parent, or affiliates off limits, or does the monitor have free rein to look in every corner of the physical plant and the company's books and records? Are there foreign or local laws, union contracts, confidentiality agreements, privileges, or other factors that may or should impede the monitor's access to certain information?

Scope is often a balance between the desires of the government and the company. The government will want the monitor to have the authority and access necessary to ensure compliance in whatever areas of concern gave rise to the monitorship and, potentially, beyond. The company might wish to limit the scope of the monitorship to certain contracts, time periods, or corporate areas in order to reduce costs or for other reasons. Ultimately, if limiting the monitor to discrete areas, periods, or matters is important to the company, counsel should be sure to negotiate those limits up-front and to get them in writing in the monitoring agreement.

Two: Select Your Monitor Wisely

Whether a company has input into the selection of the monitor can be a point of negotiation. Often, the monitoring agreement allows the company to work with the government to identify a mutually acceptable monitor. If such a joint effort fails or is not allowed under the monitoring agreement, then it is agreed that the government alone chooses the monitor.

When the company can weigh in, it should look for someone with the requisite experience and reputation to command the confidence of the government and the company alike. It also should look for someone who is flexible and practical enough to do what needs to be done without duplicating effort or otherwise wasting resources. Further, it should look for someone who can get along with both the government and the company's counsel and employees, and who has the judgment to handle conflict fairly. By these criteria, the company's recommendation may well turn out to be someone who is acceptable to the government as well.

Three: Prepare the Company Before the Monitor Arrives

By the time a monitorship begins, the company likely already has undergone extensive government and internal investigations. The company should use the knowledge gained along the way to alter its practices and to prepare to make a good impression on the monitor from the start.

Make sure that policies *and practices* change, as necessary. For example, where concerns about off-the-books payments gave rise to government investigation initially, not only should any such payments end, but also all outgoing payments should be recorded in a transparent manner. If issues concerned revenue recognition, not only should clear standards be developed, but also they should be conveyed to all relevant employees through formal training. If the problem was alleged public corruption, all ties to the officials involved should be severed in a way that the monitor can verify. Such internal pre-emptive steps can dramatically reduce the ultimate cost and burden.

Internal communications from senior management are vital in setting the stage for success. They should convey the importance of and the company's commitment to the monitorship to all levels of the company. The monitor may want to interview the CEO once, but the forensic accountants may talk to mid-level employees in the accounts payable department several times. For employees to be an effective part of the process, the process must be clear to them, and they must understand that they should provide information in a timely and forthcoming manner. They also must know that their managers will support their active participation.

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Most, if not all, such changes made in preparation for a monitorship will be beneficial, even if a monitor were not in place. Sensible controls and commitment to compliance will help reduce the company's risk of future government action. It is obviously better for the company to initiate these steps itself rather than at the insistence of the monitor.

Four: Designate a Liaison

For a variety of reasons including expense, companies often choose not to have an outside lawyer involved in every interaction between the company representatives and the monitor. While some monitoring activities may be coordinated through outside counsel, the monitor likely also will require a primary liaison within the company. The company's internal liaison need not be an attorney. The internal liaison should have a strong understanding of the company's workings and of the importance of making the monitoring process go smoothly. The liaison also should have the requisite authority to provide information in a forthright, timely manner and to run interference should disputes arise. Simply put, it is important carefully to pick the person who will be the face of the company.

While it takes time, it is crucial that the liaison or someone acting at that person's direction make a record of information provided to the monitor, including documents reviewed and employees interviewed. It also is essential to document the monitor's requests, particularly when they are potentially objectionable, so that if the issue ends up before a third party for resolution, the company has a clear record of the request, its position, and how negotiations on the matter transpired. Such a central record of the progress of the monitorship also enables the company, where appropriate, to propose changes in procedures along the way. A monitor will welcome such proposals as a sign that the company is committed to the process.

Five: Pick Your Battles

Conflicts are inevitable. Some will be resolved between the monitor and the company, and others will require input from the government. The important thing is to pick your battles carefully. Is the monitor's request merely causing inconvenience, or is it truly unreasonable? If it is unreasonable, is there a more reasonable option? Would the company consider withdrawing from the monitorship over the issue?

Though it is not something to count on, it is possible to renegotiate some aspects of the monitoring agreement after the monitor begins. As with any contract, the monitoring agreement can provide only an outline of how future disputes are to be resolved. Issues may arise that neither the government nor the company anticipated and that, while allowed under the plain words of the agreement, are beyond the scope originally contemplated. If this is so, the monitor should not object to the company seeking clarification. Again, a company should choose its monitor wisely. If the appointee is a reasonable person who is willing to work with all parties involved, the process can be much smoother than otherwise.

Conclusion

Over the course of a three- to five-year time period, the work of a monitorship may appear to be a burden. With a commitment to success, however, a company may well emerge on the other side the beneficiary of changes that will sustain it for years to come.