Improving Corporate Settlement Agreements

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In the world of corporate regulatory and law enforcement, Settlement Agreements ("Agreements") have become commonplace. While under the law an organization has a person-like identity, an organization cannot be put in prison. This effectively leaves the government with two choices that fall on either end of the punishment spectrum – probation or the death penalty.

The death penalty comes in the form of putting an organization out of business, such as would be the case if the organization were, for example, primarily a government contractor placed under suspension or debarment. Because in many instances the organization, along with its owners, employees, suppliers, customers, and others, is as much a victim of the underlying misconduct as the government, consumers, and/or other interested parties, "probation" often tends to be a fair outcome. Probation also fits well with one of the chief underlying aspirations of our justice system - reform.

In the context of Agreements, this aspiration to reform is captured within each Agreement's terms/requirements ("Terms"), which invariably and necessarily focus on an organization's Compliance and Ethics Program ("Program") and internal controls. A noble goal, but one that I frequently find failing in its design in that the Terms of most Agreements lack a full and practical appreciation for what constitutes an effective Program within a particular organization.

While §8B2.1 of the United States Federal Sentencing Guidelines (USSG) has become the standard of measurement for an effective Program and the basis for the Terms of these Agreements, Programs are not "one size fits all" and Agreements to date largely fail to appreciate it. To the contrary, many Agreements appear, within and sometimes among agencies, "cookie cutter" like, using prior Agreements as templates with little or no change in the relevant compliance Program Terms.

If the architect has fundamental flaws in his/her design of a bridge, it will eventually fail, even if effectively constructed by the best bridge builders in the world. The same holds true for Programs.

Herein lies the biggest failure of the vast majority of Agreements in use today – they are not designed to achieve long-term success in remediating Programs for the purpose of preventing and/or detecting future misconduct. A key reason for this is because the parties to the Agreement miss the forest for the trees in that they too narrowly focus on Program sub-components (that piece of a Program associated with a particular risk, such as Anti-Corruption, Anti-Trust, False Claims, Organizational Conflicts of Interest, etc.…), the failure of which is only symptomatic of a higher level and overall Program failure.

Program Knowledge and Experience
Part of this failure may be due to a lack of knowledge and practical experience by those drafting the Agreements about Programs. After all, how many prosecutors, regulators, or white-collar criminal defense attorneys came from the ranks of an organization's Compliance Department? How many have received compliance & ethics program specific training and/or are Certified Compliance & Ethics Professionals (CCEPs) or hold a similar designation?

Unfortunately, the answer is hardly any.

Compromise
Another attributing factor to the design failure of Agreements is the adversity between the government and the organization, particularly the organization's white-collar defense counsel, in negotiating Agreements. On the one hand, the government desires more comprehensive reforms (though some government agencies, such as the DOJ, hamstrings itself by its practice(s), as I will explain shortly) while the organization's counsel strives, in the "best interests of the client," to achieve the least costly outcome. While counsel is of course bound to advocate in the client's best interests, I would argue that focusing on short-term costs is not in an organization's best interests. The resulting Agreement is a compromise that only cures a symptom, not the disease.

Policy vs. Practice
As it concerns the DOJ, the DOJ's practice is narrower than the DOJ's policy requires/suggest for negotiating plea agreements with corporations as it pertains to the scope of remedial measures for Programs. The relevant policy is contained in the United States Attorneys Manual (USAM) and though it is captioned at USAM 9-28.1300 as "*Plea Agreements with Corporations*," it also applies in practice to settlement agreements such as deferred and/or non-prosecution agreements.

Section 9-28.1300 of the USAM states "*It is, therefore, appropriate to require the corporation, as a condition of probation, to implement* ***a compliance program or to reform an existing one***" (**emphasis added**). Note that this Policy doesn't attach this reform to only the Program failures associated with the underlying misconduct at issue.

I am not aware of any specific DOJ policy that directs prosecutors to limit the scope of an organization's Program reforms in an Agreement to that relevant only to the underlying misconduct, though such a practice is, at least, alluded to in a March 7, 2008 DOJ memorandum for heads of department components, United States Attorneys, from Craig S. Morford entitled "*Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations*" (commonly known as the "Morford Memo").

Section B.3. of the Morford Memo, captioned "*Monitoring Compliance with the Agreement*," states: "*Principle: A monitor's primary responsibility should be to assess and monitor a corporation's compliance* ***with those terms of the agreement that are specifically designed to address and reduce the risk of recurrence of the corporation's misconduct****, including, in most cases, evaluating (and where appropriate proposing) internal controls and corporate ethics and compliance programs*" (**emphasis added**).

While some may read this and attach the emphasized clause above to the Monitor's responsibilities, such an interpretation makes no sense because a Monitor's scope is strictly and wholly dictated by the Terms of an Agreement. Terms that the Monitor had no part in drafting. Therefore, this clause must be intended for the DOJ officials who drafted the Agreement, supporting that the DOJ's practice is to focus on remedial efforts around only those aspects of a corporation's Program

associated with the specific underlying misconduct at issue. Moreover, a reading of any DOJ deferred or non-prosecution agreement will find that the scope of the Program remediation requirements within every Agreement to date affirms the narrower than Policy practice of the DOJ.

The "DOJ Effect"

Because the DOJ serves in so many ways as the example for other agencies to follow, this practice has been copied or incorporated into the policy or practice of other agencies as it regards Agreements. Agencies such as the Securities and Exchange Commission, the Environmental Protection Agency, and the Commodity Futures Trading Commission, to name a few, similarly tailor Agreements narrowly as it regards an organization's Program remediation requirements.

This narrow focus, as I stated earlier, misses the forest for the trees and reflects an incomplete understanding of overall Programs by those who draft these Agreements. The narrow focus on, for example, just the anti-corruption compliance program sub-component of an organization may serve to mitigate anti-corruption issues, but the failure of that specific compliance sub-component within an organization is merely symptomatic of a greater, broader, and overall Program failure.

Following the elements of an effective Program per §8B2.1 of the USSG and accepted as a best practice within the professional compliance and ethics field, an effective overall Program is risk-based, such that an organization susceptible to anti-corruption risks, for example, should identify that risk and incorporate policies, certifications, training, and testing/monitoring, among other actions, to address and mitigate that identified risk.

If the organization's Program failed to perform a risk assessment, missed a relevant risk, and/or ineffectively addressed a relevant risk, it is likely that the Program missed other relevant and significant risks, indicating that the Program is not designed and/or functioning effectively. By not including Terms in Agreements that focus on the overall Program, the likelihood of future misconduct in other relevant risk areas remains unaddressed.

The DOJ's view on anti-corruption matters, for example, assumes that because corruption existed in one region served by an organization, it likely existed in other regions. To address this, the DOJ requires actions by corporations intended to assess and address that assumed likelihood. This view is precisely analogous to how a compliance Program sub-component relates to the overall Program. Yet it remains unaddressed in current Agreements.

Biomet and Smith & Nephew

Two striking illustrations of this narrow focus are Biomet, Inc. ("Biomet") and Smith & Nephew, Inc. Each entered into a deferred prosecution agreement ("DPA") with the United States Attorneys Office, District of New Jersey, in or about February of 2007. Five years later, in September of 2012, each again entered into a new DPA with the Fraud Section of main DOJ.

The DPAs in 2007 were, as it concerned the remedial Program requirements and much else aside from violation specific facts, nearly word for word. It was the same for the DPAs in 2012. Because of this, I will only quote verbiage from the Biomet DPAs going forward.

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The September 2007 Biomet DPA was focused on Biomet's federal health care compliance program sub-component(s) and ignored Biomet's overall Program almost completely. While this can be seen throughout the DPA, Term #9 illustrates it well, stating: *"The Company shall implement or continue its operation of an effective corporate compliance program and function to ensure that internal controls are in place* ***to prevent recurrence of activities that resulted in the DPA****. The Company shall also develop and implement policies, procedures, and practices designed* ***to ensure compliance with federal health care program requirements, including the Anti-Kickback Statute****, with respect to all it dealings with Consultants, as defined herein, and others who cause the purchase of Company orthopedic products in the United States."* (**Emphasis added**)

In a similarly narrow manner, the March 2012 Biomet DPA focused almost exclusively on the company's anti-corruption (i.e. Foreign Corrupt Practice Act) compliance program sub-component. As with the 2007 Biomet DPA, this is evident throughout the DPA, but Term #7 serves as a good example, stating: *"Corporate Compliance Program: Biomet represents that it has implemented and will continue to implement and maintain a compliance and ethics program* ***designed to prevent and detect violations of the FCPA and other applicable anticorruption laws*** *throughout its operations, including those of its affiliates, joint ventures, contractor, and subcontractors, with responsibilities that include interactions with foreign officials or other high-risk activities."* (**Emphasis added**)

One may wonder if in another five years, in 2017, we might not see a new DPA with Biomet or Smith & Nephew for False Claims Act, Insider Trading, or some other violations!

Ethical Tone

Another fundamental defect of most Agreements is the failure to appreciate the symbiotic relationship between Ethical Tone and a Compliance Program. With the exception of just a couple of government agencies (the DOJ not being one of them), most make no mention of ethical tone whatsoever in Agreements, much less incorporate requirements intended to foster and ensure a positive ethical tone within an organization.

When it comes to ethical tone and Programs, compliance & ethics experts unanimously recognize and agree that one cannot effectively exist without the other.

It is no accident or oversight that the relevant section of the USSG, §8B2.1, the very foundation upon which all of this rests, is entitled *"Effective Compliance* ***and Ethics*** *Program"* (**emphasis added**). Yet by reading most Agreements, the "ethics" part seems to have been largely forgotten by many, if not most, government agencies.

One government agency, the Federal Energy Regulatory Commission ("FERC"), has a section "§1B2.1" under its Penalty Guidelines where it copied §8B2.1 of the USSG, but removed any and all references to ethics! It was even removed from the title of the section, which simply reads "*Effective Compliance Program."* Such a blatant and seemingly intentional disregard for the role of ethics and its relationship with compliance Programs is unconscionable to a compliance and ethics expert.

If, as the public should expect and demand, the government and organizations want to effectively remediate criminal and regulatory violations over the long-term under our current model, they must attack the root of the problems - the overall Compliance AND Ethics Programs within organizations. A piecemeal approach that overly focuses on

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Program sub-components and neglects ethical tone almost completely is doomed to failure. It is like placing a Band-Aid on an arterial wound.

Time

Another issue in most Agreements is time. Depending on the state of an organization's Program, more or less time may be necessary to effectively implement remediation. For an organization with a robust Program, whether it existed before the underlying misconduct occurred or was strengthened in response to the discovery of misconduct but prior to an Agreement, less time should be necessary to implement and assess an organization's effective compliance with the Agreement than for an organization with no Program or a very weak one.

A Program is a process, not a one-time event. Moreover, it is a process that perpetuates and improves continuously. Generally speaking, for organizations without a robust and effective Program, it realistically takes at least three years to stand up this process to the point where it is effective and begins annually repeating. One year to design and begin creating/re-creating the Program's components and sub-components. One year to eighteen months to implement the Program. One year to assess implementation and effectiveness and make necessary revisions to the Program process.

There have been many Agreements where a compliance expert could easily see that the time allotment was not realistic and insufficient. Take for example Wright Medical Technology, Inc. ("Wright"), who's Agreement had a twelve-month term. It was obvious to a compliance and ethics expert (at least to me when I read it after it was announced) that it was unrealistic for Wright to effectively accomplish all that was required in the Agreement in so short a time. To my point, after a year, Wright's Agreement was extended an additional year.

Drafting Effective Agreements

One doesn't hire a plumber to fix a car. First and foremost, prosecutors, government investigators, suspension & debarment officials, regulators, and white-collar defense attorneys should seek training on Corporate Compliance & Ethics Programs. These relevant parties, though they may have had tangential exposure to Programs through various matters within their respective focus and practice areas, most likely do not fully understand what constitutes an effective Program in practice or, possibly, in theory. Absent such knowledge and training, the design and effectiveness of a Program cannot be effectively assessed, much less remediated.

Opportunities for such training abound, with at least two large membership organizations well established and dedicated to compliance and ethics professionals: the Society of Corporate Compliance and Ethics (SCCE) and the Ethics & Compliance Officers Association (ECOA). The Ethics Resource Center, though not a membership organization or a major training provider like the SCCE and ECOA, has a treasure trove of relevant compliance and ethics information and resources.

Secondly, counsel should help the organizations they represent appreciate the long-term value of an Agreement that more broadly addresses Programs, rather than the short-term cost savings of one with narrower Terms. At the same time, the government should be more demanding of overall Program reforms in Agreements and not compromise the spirit of what the government seeks to accomplish through practices that are more restrictive and short sighted than what its Policy permits. If the government's Policy is overly narrow (such as with FERC), then they should seek to amend it.

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Next, incorporate Terms into Agreements that assess and appropriately seek to improve and instill a positive ethical tone and culture within an organization. As previously noted, ethical tone and Programs have a symbiotic relationship. Positive ethical tone begins at the highest ranks of an organization and there are effective means by which an organization can actively spread that positive ethical tone down and throughout the ranks of an organization.

Also, set realistic time periods that will allow an organization to contemplatively design and implement reforms effectively, without overly rushing the process. It would be better to set a longer time period with an allowance for early Agreement termination than to set one too short to ensure that the spirit of the Agreement is achieved. Organizations are much less likely to object to an early termination than an extension of an Agreement, recognizing, among other things, the positive impact an early termination may have on "market value" and the recapture of "reputation capital."

Finally, consider the utilization of Corporate Monitors ("Monitors"). Monitors are currently used in about one third of Agreements. Aside from a Monitor's scope and duties as specified under the Agreement, Monitors serve another key and unwritten role – to help ensure that the "spirit" of the Agreement is fulfilled.

Generally speaking, this "spiritual" goal is that the organization establish an effective Compliance and Ethics Program that will perpetuate, succeed, and be self-sustainable beyond the term of the Agreement, reducing recidivism along with other corporate misconduct, fraud, or regulatory violations. Where a Monitor is required, an Agreement that fails in its design may still achieve the spirit of what the parties to the Agreement desire.

Due to past negative publicity arising from problems resulting from poor/immature government agency Monitor selection policies and/or inexperienced and/or ineffective Monitors, government agencies and organizations alike have developed some misperceptions that have led to Monitors being underutilized, even avoided. While some government agencies are still developing or improving Monitor selection policies, many have already adopted policies that addressed past concerns. With the impending adoption by the American Bar Association of Standards for Corporate Monitors, it is possible that the relevant policies and practices of many or most government agencies will improve, as well as become more standardized, fair, and transparent.

The larger issue as it concerns Monitors is the experience of the person selected. Currently, many Monitors come from the ranks of white-collar defense attorneys, who, as noted above, frequently lack the requisite level of compliance and ethics training and knowledge, as well as practical Program experience, to serve in that role most effectively. Additionally, most persons selected to be a Monitor have never been a Monitor before and are unaware of the nuances associated with such a specialized role.

Having been a federal Monitor four times, I can attest to the fact that being a Monitor is not like being an accountant, lawyer, consultant, or investigator. Corporate Monitoring is a practice and specialty all to itself, often requiring a combination of skill-sets and deep experience from many disciplines, compliance and ethics expertise being the common denominator and, arguably, the most important. Because a compliance and ethics program is at the very heart of every Agreement regardless of the nature of the specific underlying misconduct, it is of much greater importance to engage a

Monitor who is an expert in compliance and ethics rather than one who is an expert on the substantive underlying criminal and/or regulatory violations.

This is by no means to infer that white-collar defense attorneys or other professional service providers outside of compliance and ethics (i.e. auditors, forensic accountants, accountants, management consultants, etc.…) should be instantly removed from consideration as a Monitor. To the contrary, such backgrounds provide a firm foundation to becoming a great Monitor. It is only intended to focus the attention of the parties to an Agreement on a Monitor's requisite experience relevant to each particular matter in order to ensure the selection of an effective (and efficient) Monitor.

Using the analogy of an expert witness, every expert witness has to have a first opportunity to testify. Just because a person has not testified before doesn't mean they can't qualify. Or do an outstanding job.

But it is this lack of experience and knowledge that leads to inefficiencies and missteps by Monitors that frequently and unnecessarily increase costs, cause operational disruptions, leads to disputes, or results in Programs that cannot be self-sustained by an organization beyond the term of the Agreement.

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Thoughts or comments about this paper are welcomed at JHanson@ArtificeForensic.com.

About the Author:

John Hanson has over twenty-four (24) years of fraud investigation, forensic accounting, corporate compliance & ethics, and audit experience. Much of John's professional experience has been in federal criminal law enforcement, having served for nearly ten (10) years as a Special Agent with the Federal Bureau of Investigation. John has conducted hundreds of investigations involving complex fraud schemes, including Ponzi and Pyramid schemes, embezzlements, money laundering, identity theft, telemarketing fraud, bankruptcy fraud, public corruption, anti-corruption, securities fraud, health care fraud, mortgage fraud, charitable fraud and bank fraud.

John has most recently become known for his contributions, work, and thought leadership in the field of Independent Corporate Monitoring, a practice area involving the imposition of an independent third party by a government agency or department upon a corporation to verify that corporation's compliance with the terms of a settlement agreement. John has previously served in a leadership role in a federal Monitorship and was involved in four other federal Monitorships: two as the named Monitor, one as the "Independent Business Ethics Program Evaluator" and the other in support of the named Monitor. In these roles, John has reported to the Department of Justice, the Department of Interior, the Department of Transportation, the Small Business Administration, the Federal Highway Administration and the Massachusetts Department of Transportation. John was also a voting member of the American Bar Association, Criminal Justice Section's Task Force on Corporate Monitor Standards, which developed Standards and "best practices" for Corporate Monitors.

John is also a Certified Public Accountant (Louisiana), a Certified Fraud Examiner, and a Certified Compliance & Ethics Professional.