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CORPORATE COMPLIANCE

Two Akin Gump attorneys discuss the ramifications of hiring an independent monitor. Where allegations warrant some form of public disclosure, organizations should first establish the facts under the cloak of privilege before engaging an independent monitor to issue recommendations and assess the organization's progress toward those recommendations. The recent blurring of internal investigations and independent monitorships has undermined the goal of reputational recovery.

## Independent Monitorships and Corporate Reputation

BY CONNOR MULLIN AND MARK MACDOUGALL

Nearly every week brings news of a high-profile organization hiring an independent monitor, usually as part of a settlement agreement with the government or court-ordered probation.[1]

Increasingly, the engagement of an independent monitor is announced as part of a voluntary crisis management plan. From Penn State University after the Jerry Sandusky scandal,[2] to General Motors Corp. following a widespread ignition switch defect,[3] to New York University in the wake of reports of labor violations in Abu Dhabi,[4] to the American Psychological Association (APA) in response to allegations that the APA enabled the torture program of the Central Intelligence Agency,[5] the rise of the reputational monitorship is unmistakable. Following damaging public reports, elements of corporate monitorships, including an independent investigator and a commitment to issue public findings, have become integral to the internal investigation model. As recent highly publicized cases have shown, these hybrid legal engagements—in which a law firm is hired by an organization to conduct an indepen-

[1] See Gibson Dunn, *Year-End Update on Corporate Non-Prosecution Agreements (NPAS) and Deferred Prosecution Agreements (DPAS)* (Jan. 6, 2015), available at http://www.gibsondunn.com/publications/pages/2014-Year-End-Update-Corporate-Non-Prosecution-Agreements-and-Deferred-Prosecution-Agreements.aspx (noting that in 2014, federal law enforcement agencies entered into 19 settlement agreements that required a monitorship).

[2] See Freeh Sporkin & Sullivan LLP, *Report of the Special Investigative Counsel Regarding the Actions of the Pennsylvania State University Related to the Child Sexual Abuse Committed by Gerald A. Sandusky* (July 12, 2012), available at http://progress.psu.edu/assets/content/REPORT_FINAL_071212.pdf (hereinafter Freeh Report).

[3] See GM press release, *GM Receives Extremely 'Thorough,' 'Brutally Tough' and 'Deeply Troubling' Valukas Report* (June 5, 2014).

[4] See Nardello & Co. Report of the Independent Investigator into Allegations of Labor and Compliance Issues During the Construction of the NYU Abu Dhabi Campus on Saadiyat Island, United Arab Emirates (April 16, 2015), available at http://www.nardelloandco.com/pdf/NYU%20Abu%20Dhabi%20Campus%20Investigative%20Report.pdf.

[5] See APA press release, *APA Announces Independent Review of Collusion Charges* (January 2015), available at http://www.apa.org/monitor/2015/01/upfront-charges.aspx.

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dent investigation or serve as a monitor—may not ultimately serve the goal of preserving corporate reputation.

## History

Monitorships and internal investigations do not share a common history. Independent monitors were originally creatures of courts. As early as the 16th century, English chancery courts employed special masters to independently monitor compliance with court orders.[6] In *Bleak House*, Charles Dickens blamed masters for the famously endless litigation in Jarndyce and Jarndyce.[7] In the U.S., courts have appointed a range of similar third party agents—receivers, masters, special masters, hearing officers, and independent monitors[8]—many with similarly unhappy results. On Dec. 3, 1921, *The New York Times* reported that Judge Julius M. Mayer of the U.S. Court of Appeals for the Second Circuit had appointed ''his former law partner,'' Abraham S. Gilbert, to serve as special master in eight gas rate cases.[9] Gilbert collected $90,000 in fees from the gas companies, equivalent to roughly $1.2 million in today's dollars.[10] The U.S. Supreme Court, then led by Chief Justice William Howard Taft, who as President appointed Mayer to the bench, cut the master's fees in half, concluding that the master's ''compensation should be liberal, but not exorbitant.''[11] After acknowledging that the monitor rendered ''for the most part excellent services,'' the Supreme Court noted with particular sensitivity that the fees were ''fifteen times the salary of the trial judge and eight times that received by justices of this court.''[12]

Judicial salaries were an appropriate model because masters performed a judicial function. Masters owed limited duties to monitored organizations and maintained the same independence that judges upheld in their dealings with litigants.[13] For decades, courts have required companies to retain independent monitors following a conviction or as part of court-ordered probation.[14] In the 1990s, state and federal law enforcement agencies began including provisions in nonprosecution and deferred prosecution agreements requiring the appointment of a monitor ''to assess and monitor a corporation's compliance with the terms of the [settlement] agreement [and] address and reduce the risk of recurrence of the corporation's misconduct.''[15]

**Line Becomes Blurred.** Unlike monitorships, internal investigations did not emerge from the court system, but developed as a private alternative to sustained oversight by the Securities and Exchange Commission.[16] In the 1960s, the SEC began imposing expensive receivers and special agents on companies in connection with securities fraud actions.[17] Almost immediately, companies proposed conducting their own internal investigations without active government involvement.[18] The Foreign Corrupt Practices Act of 1977 (FCPA) ushered in a new breed of internal investigation. Companies began preemptively initiating internal investigations to minimize exposure to an enforcement action.[19] Internal investigations conducted by in-house counsel gave way to independent investigations conducted by outside counsel, coupling ''the appearance of a genuine attempt at disclosure and future compliance'' with ''the ability to control the messaging and use of the attorney's work product.''[20] In 2012, the SEC Director of Enforcement cited ''an increasing frequency of internal investigations that are not as objective and searching. These tend to be more like advocacy pieces for current management rather than reflecting what is in the best interest of the real client, the shareholders who own the company.''[21] Faced with pressure to engage truly independent investigators and make public disclosures following reports of misconduct, organizations have blurred the line between independent monitorships and internal investigations.

## Independence of Monitors

Organizations expect and are often assured by their lawyers that the critical protections of professional con-

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[6] See Margaret G. Farrell, Special Masters, in Reference Manual on Scientific Evidence 579 n.1 (1st ed. 1994) (''[T]he appointment of persons acting as masters may go back to the time of Henry VIII.''); Caelah E. Nelson, *Corporate Compliance Monitors are Not Superheroes with Unrestrained Power: A Call for Increased Oversight and Ethical Reform*, 27 GEO. J. LEGAL ETHICS 723, 724 (2014); Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar*, 105 MICH. L. REV. 1713, 1715 (2007).

[7] Charles Dickens, *Bleak House*, ch. 1 (1852) (''From the master, upon whose impaling files reams of dusty warrants in Jarndyce and Jarndyce have grimly writhed into many shapes.'').

[8] Nelson, supra note 6, at 2.

[9] *Master In Gas Case Gets Fee of $57,500*, N.Y. TIMES, Dec. 3, 1921, available at http://query.nytimes.com/mem/archivefree/pdf?res=990DEFD81431EF33A25750C0A9649D946095D6CF.

[10] *Id.*

[11] *Newton v. Consolidated Gas Co.*, 259 U.S. 101, 105 (1922).

[12] Id. at 106. Monitor fees remain a controversial subject. In 2007, then-U.S. Attorney for the District of New Jersey Chris Christie (R) appointed his former boss, Attorney General John Ashcroft, to monitor the medical device company Zimmer Holdings. Ashcroft's firm collected $52 million from the company.

[13] Nelson, supra note 6, at 2.

[14] Veronica Root, *The Monitor-''Client'' Relationship*, 100 Va. L. Rev. 523, 529 (2014) (citing *Ruiz v. Estelle*, 679 F.2d 1115, 1161 (5th Cir. 1982)) (''The power of a federal court to appoint an agent to supervise the implementation of its decrees has been long established.''). See also U.S. Sentencing Guidelines Manual § 8D1.3(c).

[15] Memorandum from Craig S. Morford, acting deputy attorney general, to heads of department components and U.S. attorneys (March 7, 2008), available at http://www.justice.gov/dag/morford-useofmonitorsmemo-03072008.pdf (hereinafter Morford Memorandum).

[16] Arthur F. Mathews, *Internal Corporate Investigations*, 45 Ohio St. L.J. 655, 656-57 (1984).

[17] Id.

[18] Lucian E. Dervan, *International White Collar Crime and the Globalization of Internal Investigations*, 39 Fordham Urb. L.J. 361, 363-64 (2011).

[19] Dervan, supra note 18, at 365.

[20] Veronica Root, *Modern-Day Monitorships*, 33 Yale Journal of Regulation __ (2015) (forthcoming).

[21] Ted Knutson, Interview: SEC Enforcement Division Director Robert Khuzami, Thomson Reuters News & Insight, April 4, 2012, available at http://newsandinsight.thomsonreuters.com/Securities/News/2012/04_-_April/Interview__SEC_Enforcement_Division_Director_Robert_Khuzami/.

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fidentiality, the attorney-client privilege, and the attorney work-product doctrine will govern the conduct of an investigation or a monitorship by an outside law firm. But the charter of a truly independent investigator who is empowered to ''follow every lead'' and ''make full disclosure'' inevitably conflicts with the duties of a lawyer to maintain his or her client's secrets and protect privileged communications and work product. The prosecution and conviction of Penn State assistant football coach Jerry Sandusky, and the handling of the scandal and its legal aftermath by the university's board of trustees, provides a recent example of how the roles of the independent investigator and lawyer can collide.

On Nov. 21, 2011, ESPN's Bob Ley summarized the scandal engulfing Penn State:

> With former assistant football coach Jerry Sandusky facing 40 counts of child sex abuse, with two former senior University officials facing felony charges in an alleged cover-up, with Joe Paterno fired, and the school's very name an international target of harsh scrutiny, with all of that, Penn State University today announced its own investigation of its handling of the alleged events. The probe will be conducted by former FBI director and former federal judge Louis Freeh.[22]

During the press conference, Freeh stated: ''We have been asked to do this with a commitment to show no favoritism toward any of the parties whose action[s] we will be reviewing, including the Board of Trustees, [who] assured us of total independence, so that this mandate can be fulfilled.[23]

The documents memorializing the engagement resemble a traditional internal investigation conducted by outside counsel. The now-public engagement letter contains language typical of any law firm's billing policies and the rates that would be charged to the Board of Trustees.[24] Although broad, Freeh's marching orders—''to follow any lead, to look into every corner of the University to get to the bottom of what happened and then to make recommendations that ensure that it never happens again''[25]—are similar to an internal investigation with a broad scope of engagement. Even Freeh's commitment to ''immediately report any discovered evidence of criminality'' and ''[any victims of sexual crimes or exploitation] to the appropriate law enforcement authorities''[26] is consistent with the ethical obligations of any lawyer.[27]

Like an internal investigation, the parties also tried to preserve the attorney-client privilege and the work-product doctrine.[28] The 267-page Freeh Report cites dozens of confidential internal e-mails, notes, and letters,[29] as well as excerpts from Penn State's communications with its former outside counsel.[30] As the Sixth Circuit noted, ''[T]he oldest of the privileges for confidential communications known to the common law . . . is not a creature of contract, arranged between parties to suit the whim of the moment.''[31] While voluntary disclosure does not necessarily waive work-product protection, courts almost uniformly reject the concept of selective waiver of the attorney-client privilege. One court found that ''every appellate court that has considered the issue in the last twenty-five years'' has held that parties cannot ''waive the attorney-client privilege selectively.''[32] As a result, the government and monitored organizations have abandoned attempts to characterize disclosure to the government as a selective waiver of privilege. Nearly every recent settlement agreement with the government prohibits an attorney-client relationship between the company and monitor.[33]

In November 2012, former Penn State president Graham Spanier and two former Penn State officials were indicted for their alleged roles in covering up abuse. Perhaps as a result of the independent investigation, the University has otherwise avoided criminal charges. When the NCAA installed former Sen. George Mitchell as Penn State's ''independent athletics integrity monitor,'' he deferred to many of the findings in the Freeh Report and credited the University for its progress in achieving Freeh's recommendations.[34]

## Results of Report

While Freeh's independent investigation seems to have spared the University additional criminal charges and stiffer NCAA sanctions, the Freeh Report bolstered a number of civil lawsuits. In 2013, Penn State announced that it paid $59 million to 26 Sandusky victims as part of a ''global'' settlement, but other cases are pending. Meanwhile, Spanier, the former Penn State president, sued Freeh for defamation. Several months after the release of the Freeh Report, Joe Paterno's estate sued the NCAA, naming Penn State as a nominal defendant. The Paterno estate is seeking compensation for contractual, reputational, and other damages that allegedly flowed from the Freeh Report's findings.[35] Paterno's estate sought documents Freeh gathered during the course of the investigation, including interview notes and internal memoranda.[36] The Centre County Court of Common Pleas concluded: ''At no point does

[22] *Outside the Lines* (ESPN television broadcast Nov. 21, 2011).

[23] Id.

[24] See Engagement Letter from Louis J. Freeh to Steve A. Garban ¶ 2 (Nov. 18, 2011).

[25] Freeh Report, supra note 2, at 11.

[26] See Engagement Letter, supra note 25, at ¶ 1.

[27] See generally Model Rules of Prof'l Conduct R. 1.6, 1.13.

[28] See Engagement Letter, supra note 25, at ¶ 6; see also Freeh Report, supra note 2, at 9.

[29] See Freeh Report, supra note 2, at 165-232.

[30] See, e.g., id. at 52, 59, 62, 217.

[31] *Tenn. Laborers Health & Welfare Fund v. Columbia/Hca Healthcare Corp.*, 293 F.3d 289, 303 (6th Cir. 2002).

[32] *United States v. Reyes*, 239 F.R.D. 591, 603 (N.D. Cal. 2006).

[33] See, e.g., Deferred Prosecution Agreement at D-7, *United States v. Alstom Grid Inc.*, No. 3:14-cr-00247 (D. Conn. 2014), http://www.justice.gov/sites/default/files/opa/press-releases/attachments/2014/12/22/alstom_grid_dpa.pdf (''The parties agree that no attorney-client relationship shall be formed between the Company and the Monitor.''); Deferred Prosecution Agreement, *United States v. Daimler AG*, No. 1:10-cr-00063 at Attachment D § 6 (D.D.C. March 24, 2010), http://www.justice.gov/criminal/fraud/fcpa/cases/daimler/03-24-10daimlerag-agree.pdf (''The parties agree that the Monitor is an independent third-party, not an employee or agent of Daimler or the Department, and that no attomey-c1ient relationship shall be formed between Daimler and the Monitor.'').

[34] Root, supra note 21, at 36.

[35] See Complaint, *Estate of Joseph Paterno, et al.v. National Collegiate Athletic Association (''NCAA'') et al.*, No. 2013-2082 (Court of Common Pleas of Centre County, Pa.).

[36] See Opinion and Order 18-19 n. 3, *Estate of Joseph Paterno, et al.v. National Collegiate Athletic Association (''NCAA'') et al.*, No. 2013-2082 (Court of Common Pleas of Centre County, Pa., Sept. 11, 2014).

the scope [of engagement] mention a purpose of securing either an opinion of law, legal services, or assistance in a legal matter . . . . As a result, any source documents Penn State turned over to the Freeh Firm for the purpose of conducting the investigation are not privileged.''[37] In a lawsuit brought by ''John Doe D,'' one of several alleged victims of Sandusky, another Pennsylvania state court ordered the University to produce ''all documents in the 'Freeh Database'—a database of roughly 3.5 million electronic records collected by Freeh Sullivan & Sporkin LLP.''[38] In an April 9, 2015, special meeting of the Penn State Board of Trustees, some trustees voted against authorizing any additional settlements based on what the trustees characterized as exaggerated culpability attributed to the University in the Freeh Report. As one trustee stated, ''Every day that we silently stand in support of the Freeh Report is a day that we allow the world to believe that we agree with its conclusions.''[39]

## Conclusion

When independent monitors issue reports to the government or general public, the findings typically address the company's implementation of a compliance program, not past misconduct. Although imperfect, there are a number of protections available to monitored companies to prevent third parties from exploiting the monitor's fieldwork.[40] Unlike these forward-looking disclosures, the Freeh Report concludes, ''The most saddening finding by the Special Investigative Counsel is the total and consistent disregard by the most senior leaders at Penn State for the safety and welfare of Sandusky's child victims.''[41]

Penn State is now facing civil lawsuits without the privilege protections that would in the context of an internal investigation accompany such a devastating conclusion. Where allegations warrant some form of public disclosure, organizations should first establish the facts under the cloak of privilege before engaging an independent monitor to issue recommendations and assess the organization's progress toward those recommendations. The recent blurring of internal investigations and independent monitorships has undermined the goal of reputational recovery.

[37] Id. at 20-21.

[38] Order, *John Doe D v. The Pennsylvania State University, et al.*, No. 2298 (Court of Common Pleas of Philadelphia County, Pa. Jan. 9, 2015).

[39] Statement of Trustee Alice Pope, Special Meeting of the Penn State Board of Trustees (April 9, 2015), available at https://www.youtube.com/watch?v=_ikrXK2JRs4.

[40] F. Joseph Warin, Michael S. Diamant, and Veronica S. Root, *Somebody's Watching Me: FCPA Monitorships and How They Can Work Better*, 13 J. Bus. L. 321, 375-80 (2013).

[41] Freeh Report, supra note 2, at 14.

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