

The Business Magazine  
For The Chief Legal Officer

# CORPORATE counsel

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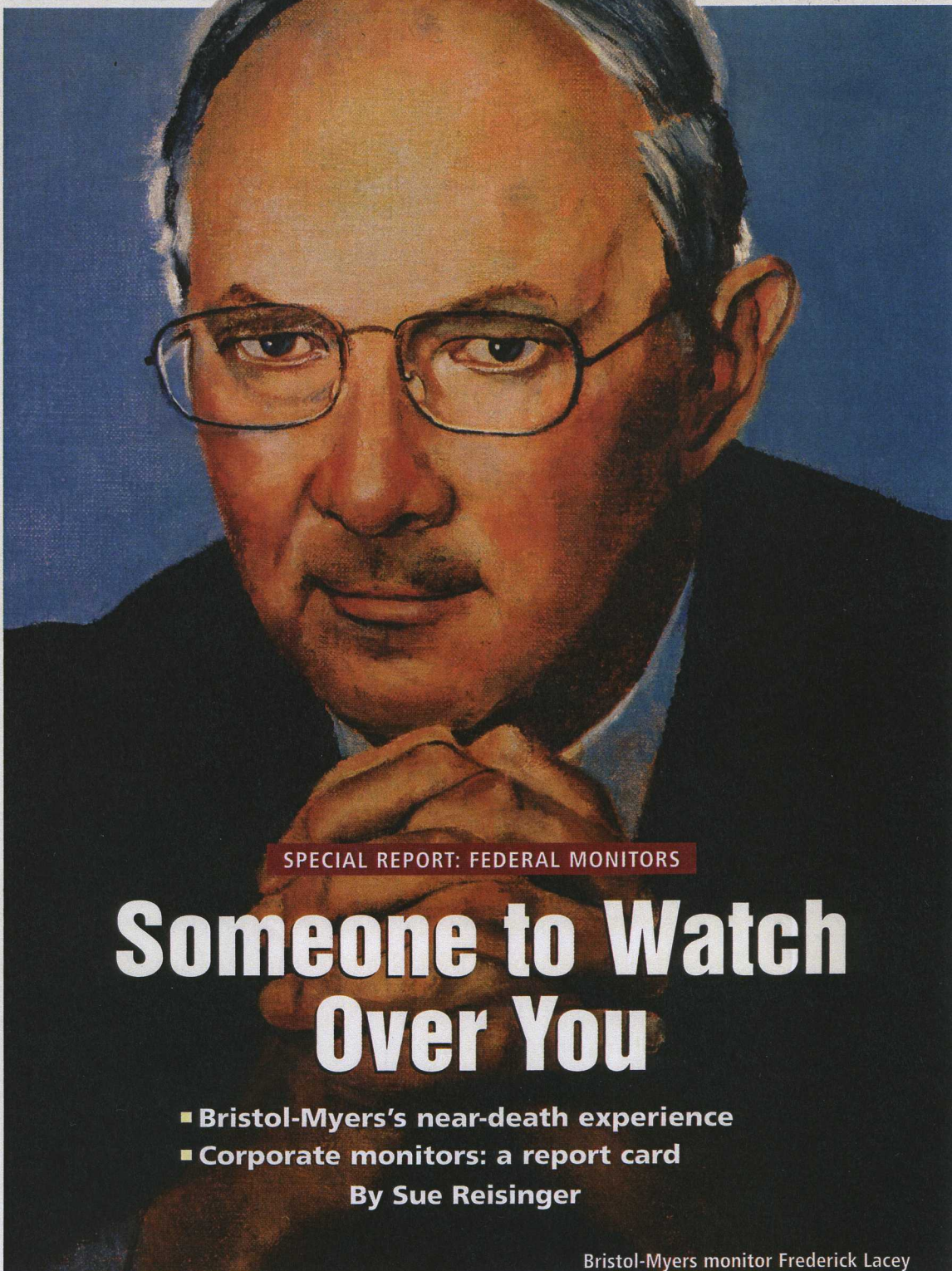
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SPECIAL REPORT: FEDERAL MONITORS

## Someone to Watch Over You

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- Corporate monitors: a report card

By Sue Reisinger

Bristol-Myers monitor Frederick Lacey



BY SUE REISINGER

# Someone to Watch Over You

Corporate monitors are secretive, costly, and have the power to bring a company to its knees, according to our exclusive study of 28 Justice Department agreements.

**B**EING A CORPORATE MONITOR FOR THE U.S. DEPARTMENT OF JUSTICE CERTAINLY has its perks—power, prestige, top pay. But it can have its dark side, too. Just ask Margaret Finerty, a former New York judge who worked as a monitor three years ago at the New York Racing Association Inc., which is based in Queens. The horse racing organization had collaborated with betting tellers in a scheme to evade state taxes. To avoid being indicted, it signed a deferred prosecution with Roslynn Mauskopf, the U.S. attorney for the Eastern District of New York, and agreed to enact sweeping reforms under the direction of a monitor, or outside overseer.

As part of those monitoring duties, Finerty or her staff would show up daily at 6 A.M. on the seedy backstretch at Saratoga to interview grooms, walkers, and exercise workers. They'd return again every evening after the races.

During one visit in mid-2005, a jockey's agent refused to answer questions from the monitoring team and allegedly threatened to harm a staffer, according to court documents. No one would discuss details of the incident, including Finerty, who coordinates the independent monitor practice at Getnick & Getnick, a law firm in Manhattan. At the time, the firm reported the threat to the racing association, which banned the agent.

He retaliated by calling and harassing the law firm even after its final report was filed 18 months later, records show. The agent's lawyer even threatened to sue the firm unless his client's track privileges were reinstated. The law firm finally went to court for an injunction against the man and his lawyer.

Most monitors don't face violent threats, only recalcitrant executives. In general, monitors are experts, usually lawyers, appointed by a govern-

ment agency or judge on the city, state, or federal level to temporarily oversee a company or organization accused of wrongdoing. First used by the Justice Department in 1994, monitors are a relatively new device in criminal law enforcement.

They are sometimes—though not always—required when a company is accused of a federal crime and has signed a deferred or nonprosecution agreement to avoid trial. The common thread for all monitors is that they must be independent of the corporation, brought in from the outside.

Paul McNulty, deputy attorney general until this summer and now a partner with Baker & McKenzie in Washington, D.C., argues that monitors give law enforcement a powerful policing resource at no cost to the taxpayer; companies or organizations pay the full cost. He concedes that he has no proof that monitoring pays off. But he adds, "We saw monitors work well in labor unions [before using them in companies]. My sense is that they have contributed in a significant way to cleaning up corporate corruption." As a result, the Justice Department has sharply

increased its use of corporate monitors to support criminal enforcement in the post-Enron era, much to the chagrin of businesses in America.

To shed more light on this growing phenomenon, *Corporate Counsel* analyzed the 28 Justice Department deferred and nonprosecution agreements—from 1994 through August 1, 2007—that included the appointments of monitors [see page 103]. We also interviewed former and current monitors and in-house counsel who worked with monitors, as well as McNulty, who chaired Justice's Corporate Fraud Task Force and authored the controlling statement on federal prosecution of business organizations—the "McNulty Memorandum."

To our knowledge, this is the deepest look yet into the very private world of corporate monitoring. Our study found overall that monitor agreements can vary greatly from one U.S. attorney to another, and these variations can have huge ramifications for companies. The Justice Department offers no firm guidelines on monitors, leading to disparate treatment of businesses. McNulty defends this difference, saying that each U.S. attorney

PHOTOGRAPHY BY MATT GREENSLADE





Margaret Finerty knows the dark side of being a federal monitor. She helped the New York Racing Association enact a number of reforms, but a jockey's agent resisted and harassed her firm.

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George Stamboulidis, a three-time corporate overseer, says that a monitor's expenses pale in comparison to the cost of civil litigation.

needs discretion to shape a prosecution agreement as well as the monitoring role to the company and its crime.

Sometimes the differences in agreements are minor. For instance, the agreements may refer to an appointee as a monitor, examiner, consultant, or special compliance officer. (For simplicity, we are calling them all monitors.) The pacts may appoint a monitor for months

or years. They may require the monitor to report to the company, a U.S. attorney's office, the Justice Department, or any other state or federal agency that regulates the industry.

Or the differences can be highly significant. For example, some agreements grant sweeping powers to the monitors, while others limit their authority. Given that use of monitors is on the upswing, it's important for general counsel—even those who think their company will never face these problems—to learn about the soft spots in the system. In the five areas

listed below, according to our research, GCs can have enormous influence over the terms that define a monitor's job.

#### CHOOSING A MONITOR

Most prosecution agreements outline how the monitor will be chosen, and they range from giving a company total say over who that person is to no control over the selection. For example, Bristol-Myers Squibb Company was able to choose its monitor as long as he was "agreeable" to U.S. Attorney Christopher Christie of New Jersey. As



## The Third Wheels

The Justice Department has signed off on 28 federal monitors in the last 13 years.

Company	DPA or NPA*	Year Signed	Allegation	Monitor**	Monitor's Background
Prudential Equity Group, LLC	DPA	1994	Securities fraud	Kenneth Conboy	Ex-U.S. judge; Latham & Watkins, NYC
Coopers & Lybrand International	NPA	1996	Bidding process fraud	Ralph Muoio	Partner, Caplin & Drysdale, D.C.; retired
Aurora Foods, Inc.	NPA	2001	Accounting fraud	Aaron Marcu	Ex-U.S. prosecutor; partner, Covington & Burling, NYC
Merrill Lynch & Co., Inc.	NPA	2003	Securities fraud	George Stamboulidis	Ex-U.S. prosecutor; Baker & Hostetler, NYC
The New York Racing Association Inc.	DPA	2003	Tax fraud	Margaret Finerty & Neil Getnick	Ex-NYC judge; attorney, Getnick & Getnick, NYC
Canadian Imperial Bank of Commerce	DPA	2003	Accounting fraud	Michael Considine	Ex-U.S. prosecutor; Day Pitney, NYC
Symbol Technologies, Inc.	NPA	2004	Accounting fraud	Douglas Jensen	Ex-U.S. prosecutor; now counsel, Chadbourne & Parke, NYC
Computer Associates, Inc.	DPA	2004	Securities fraud	Lee Richards III	Ex-U.S. prosecutor; Richards Kibbe & Orbe, NYC
AOL	DPA	2004	Securities fraud	James Robinson	Ex-U.S. asst. atty. gen.; Cadwalader, Wickersham & Taft, D.C.
Edward D. Jones & Co.	DPA	2004	Securities fraud	James Doty	Ex-GC of SEC; Baker Botts, D.C.
InVision Technologies, Inc.	NPA	2004	FCPA violation	William "Bill" Pendergast	Ex-U.S. prosecutor; Paul, Hastings, Janofsky & Walker, D.C.
Monsanto Company	DPA	2005	FCPA violation	Timothy Dickinson	Partner, Paul, Hastings, Janofsky & Walker, D.C.
Micrus Endovascular Corp.	NPA	2005	FCPA violation	Jan Handzlik	Ex-U.S. prosecutor; partner, Howrey, L.A.
Bristol-Myers Squibb Company	DPA	2005	Securities fraud	Frederick Lacey	Ex-U.S. judge; spec. counsel LeBoeuf, Lamb, Greene & MacRae, Newark
KPMG	DPA	2005	Tax fraud	Richard Breeden	Ex-chairman, SEC; Breeden Capital Management LLC, Greenwich, Conn.
Bank of New York	NPA	2005	Fraud, money laundering	George Stamboulidis	(See Merrill Lynch entry)
University of Medicine & Dentistry of New Jersey	DPA	2005	Medicaid fraud	Herbert Stern	Ex-U.S. judge; partner, Stern & Kilcullen, Roseland, N.J.
Roger Williams Medical Center	DPA	2006	Public corruption	Margaret "Meg" Curran	Ex-U.S. prosecutor; private practice, R.I.
American International Group, Inc.	NPA	2006	Securities fraud	James "Jim" Cole	Ex-U.S. prosecutor and partner; Bryan Cave, D.C.
HealthSouth Corp.	NPA	2006	Accounting fraud	Michael Useem	Consultant and professor, Wharton School, University of Pennsylvania, Philadelphia
The Boeing Company	NPA	2006	Procurement fraud	George Babbitt Jr.	USAF general retired; BearingPoint Inc., McLean, Va.
Mellon Financial Corp.	NPA	2006	Tax fraud	George Stamboulidis	(See Merrill Lynch entry)
MRA Holdings, LLC	DPA	2006	Obscenity violation	Lori Pelliccioni	Ex-U.S. prosecutor, acting general counsel at DaVita Inc., San Diego
Statoil ASA	DPA	2006	FCPA violation	Joseph Warin	Ex-U.S. prosecutor; Gibson, Dunn & Crutcher, D.C.
Schnitzer Steel Industries, Inc.	DPA	2006	FCPA violation	James Asperger	Ex-U.S. prosecutor; O'Melveny & Myers, L.A.
Vetco International Ltd.	DPA	2007	FCPA violation	Richard "Rick" Weinberg	Ex-U.S. prosecutor; Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, NYC
Baker Hughes Inc.	DPA	2007	FCPA violation	Stephen Fishbein	Ex-U.S. prosecutor; partner, Shearman & Sterling, NYC
ITT Corporation	DPA	2007	Arms exports violation	Not yet named	NA

\*Deferred prosecution agreement or nonprosecution agreement.

\*\*Any independent monitor/consultant/examiner appointed under an agreement with Justice.

Source: U.S. Department of Justice records and *Corporate Counsel* research.





CA general counsel Kenneth Handal says that he relied on his monitor's authority to fire people.

a result, Bristol-Myers picked former federal district court judge Frederick Lacey, who was already working with the company on securities reform [see "Doctor's Orders," page 94].

In other cases, companies submitted a list of acceptable names to the judge hearing the matter or the U.S. attorney, who then picked the monitor from the list. Lee Richards III says that's how he was chosen as a monitor two years ago at CA, Inc. (formerly Computer Associates International) on Long Island. (The software company had entered a deferred prosecution agreement in September 2004 for securities fraud and obstruction of justice.) The company submitted five names to the U.S. attorney in Brooklyn, who cut it to three and sent it on to the judge. The judge picked Richards, a former assistant U.S. attorney in Manhattan and a name partner

in Richards Kibbe & Orbe in New York.

Then there's the other extreme, where the company has little or no input. For instance, in the racing association case, the court first ran an ad soliciting applications from would-be monitors. The judge then chose Finerty's law firm from the list of applicants.

ITT Corporation has no say in choosing a monitor. That was part of the punishment it received after admitting that it illegally exported U.S. military technology for night vision goggles to other countries. ITT signed an unusually long, five-year deferred prosecution agreement in March on one count, and pled guilty to two other counts. Prosecutors also slapped the tech company with what it called one of the highest criminal penalties ever, \$100 million. And Justice said that it, not ITT, would choose the monitor (as of press time, one had not yet been named).

One thing is clear from our study of the 28 Justice Department agreements:

Prosecutors really like to pick ex-prosecutors as monitors. Of the 25 monitors in our study (George Stamboulidis was named three times), at least 17 were ex-federal prosecutors like CA's Richards. Four monitors were former judges. There's also a former SEC chairman and an ex-SEC general counsel.

#### **LIMITING THE POWER**

To rein in a monitor's authority, a general counsel should pay close attention to the prosecution agreement her company signs with Justice. Some agreements grant sweeping powers to the monitor to look into almost every aspect of the company, and even demand that the business enact everything the monitor recommends.

That was the case at the University of Medicine & Dentistry of New Jersey, which signed a deferred prosecution agreement in 2005 over charges of Medicaid fraud. U.S. Attorney Christie appointed former federal district court

JEFFREY WEISS



and general counsel at Bristol-Myers, and of the general counsel at UMDNJ. Also at UMDNJ, Stern recommended candidates for a new university president after insisting that an interim president had to go. And Christie and Stern interviewed the board of trustee's choice for president before they signed off on the new hire, according to part of the monitor's report that has been made public.

In the wake of such actions, some critics say that the government is giving too much power to monitors. Richards, who just ended two years as the CA monitor, says monitors should be used judiciously, and only in severe cases. He fears that the federal government "has fallen in love" with monitorships in tackling corporate crime.

If management is clean, the board did an independent probe, and the issue was properly handled, "then you don't need a monitor," says Richards. "And it's intrusive when government takes a seat in the boardroom," he adds.

Richards also has a very different approach to the job than Stern or Lacey. The monitor should point out basic problems and urge the company to solve them, he says: "My job is not to solve them, and not to dictate. I carry a big stick but use it rarely."

Indeed, the government is listening to people like Richards, says Philip Urofsky, former assistant chief of the criminal fraud section at the Justice Department. Urofsky, now a partner at Shearman & Sterling in Washington, D.C., says that several of the prosecution agreements signed in the past year, like those with Statoil ASA or Schnitzer Steel Industries, Inc., require the monitor first to develop a work plan and then to submit it to both Justice and the company for approval. "It's an effort to ensure that there is a specific scope to the

assignment, and the company can help negotiate that," Urofsky says. "If you get a monitor running up bills and sweeping too broadly, this provision should help."

Running up bills is a serious problem, notes Peter Henning, a law professor at Wayne State University in Detroit. He says top attorneys charge as much as \$800–\$1,000 an hour as monitors, plus they bring in several law firm associates, forensic accountants, and other experts. "It raises the question: Are monitors worth the cost?" Henning asks.

Most monitors and companies wouldn't discuss the money issue. But because the university in New Jersey is public, its monitor's bill was a matter of public record. Some 16 months into his two-year term, Stern has submitted bills totaling \$7.2 million, according to a university spokeswoman. Stern, who wouldn't comment, has previously said he charged the university \$500 an hour, down from his usual \$750.

Christie defended the cost when some critics howled last year. Citing Stern's finding of \$243 million of waste and fraud at the university, he told the press that the monitor's fees were "the greatest return on government dollars anyone's ever seen in the state of New Jersey."

Richards, the CA monitor, says he charges a company the same hourly rate as for any client at his firm. If a business feels gouged, he says, it can appeal to the government or even go to court. "But realistically a company going through a cataclysmic event like a WorldCom has costs that dwarf the charges of a monitor," he adds.

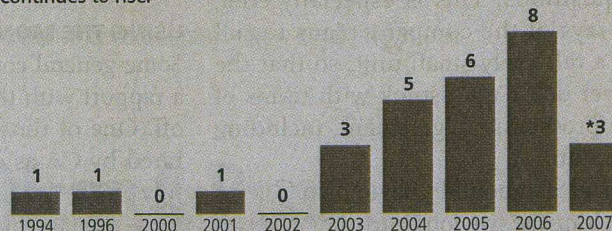
judge Herbert Stern as monitor. In the prosecution agreement, Christie gave Stern, a name partner at Stern & Kilculen in Roseland, New Jersey, authority well beyond looking at just the fraud allegations ["Fallen Star," October 2006].

Stern has power over every phase of the university's operations except the academic side. As a result, he has made recommendations to the board of trustees on everything ranging from the retention of outside counsel to the hiring and firing of senior managers. He also probed no-bid contracts, executive compensation, nepotism, and kickbacks to local doctors for referrals to the university's hospital. His inquiries led to an indictment of a New Jersey state senator, among others.

Moreover, U.S. Attorney Christie, who declined comment, and his monitors attended board meetings at Bristol-Myers and at UMDNJ and insisted on the firings of senior executives. Those demands led to the ouster of the CEO

#### SAFETY IN NUMBERS

The number of federal monitors appointed by the Justice Department continues to rise.



\*As of August 1, 2007

Source: U.S. Justice Department records and *Corporate Counsel* research



George Stamboulidis, monitor at the Bank of New York Mellon Corporation, agrees that monitors are not really that expensive, but the alternatives can be. Cost of a monitorship pales in comparison to the expense of civil litigation, Stamboulidis says, or to the cost of fighting for your company's life after an indictment.

#### PREPARING FOR CHANGE

Planning for the monitor's role in a potential merger or acquisition is also very important. Stamboulidis, who heads the white-collar criminal defense practice at Baker & Hostetler in New York, found himself caught in the middle when Mellon Bank merged with the Bank of New York on July 1. Both companies were in three-year nonprosecution agreements that required monitors. BNY already had Stamboulidis in place.

Mellon had to accept Stamboulidis as part of the merger deal, but was still required to have its own monitor. This raised the specter of dueling monitors.

Stamboulidis was spared that fate. The two banks and the two U.S. attorney offices involved, in New York and Pittsburgh, worked it out. Mellon accepted Stamboulidis, and the combined company answers to only one monitor. Stamboulidis will remain on the job, he says, until Mellon's agreement runs out in August of 2009.

So does he receive double pay? "Wouldn't that be great," he says, laughing. But he adds that no, he doesn't.

The Mellon lesson, according to Stamboulidis, is that each company should carefully negotiate language in a prosecution agreement to cover what happens during mergers or acquisitions. This is especially true, he says, if the company plans to sell off a relatively small unit, so that the buyer doesn't get stuck with terms of the prosecution agreement, including a monitor.

Did Stamboulidis have any problems meshing the two jobs into one? The two banks had very different legal issues. BNY got in trouble for money launder-

ing and lack of compliance. At Mellon, some employees mishandled and destroyed 77,000 tax returns that they were supposed to process for the Internal Revenue Service. Stamboulidis says he can't discuss how he combined the two different oversight roles. "But being a monitor is a relatively new thing," he adds. "A lot always has to be figured out as you go along."

#### NO SURPRISES

One thing that company execs have figured out already is that monitors don't like surprises. And springing one on a monitor could cost a general counsel his job.

That's what happened at Bristol-Myers last September, when Lacey ousted the chief executive and the general counsel for cutting a secret deal that landed the company in antitrust trouble. And it happened again last June, when Stern, the monitor at UMDNJ, learned from a newspaper story that the university had paid \$2.2 million to a whistleblower who was going to expose no-pay jobs. The university's interim president hadn't told Stern or the board of trustees of the whistleblower's allegations or the settlement.

Stern revealed the details in his November 2006 report. He accused the university of paying outside cardiologists up to \$150,000 a year each for no-show teaching jobs in return for referring patients to the university's heart surgery unit. Some cardiologists and administrators have since been fired, according to his report. And the university's interim president, who was hoping for the job permanently, was replaced.

#### USING THE MONITOR

Some general counsel find that having a rapport with the monitor really pays off. One of those is Kenneth Handal, hired by CA as co-general counsel in July of 2004, as part of its reform efforts. New management was in place, and the deferred prosecution agreement was signed three months later. Handal

recalls quickly forming "a wonderful relationship" with Lee Richards. He brought "another pair of eyes, and good judgment," Handal says of Richards, "and he helped shine the light on things" that needed to be fixed.

Although Handal wouldn't give a specific example, he says, "There were times when I relied on the monitor's authority to oust someone. It was helpful to have him agree that it needed to be done." Asked about that, Richards says simply, "Monitors can do and say what general counsel or chief compliance officers may feel they cannot."

When Richards's monitorship ended, CA promoted Handal to executive vice president of global risk and compliance. It was his CEO's idea, Handal says, with Richards's support. In his new job Handal, who now reports to both the CEO and the board, tries to anticipate legal problems before the government gets involved.

Richards says Handal's position is on the cutting edge of enterprise risk management. "The best companies, like Boeing and CA, are looking at risk aggressively," he says, and are assigning experts to determine the business and compliance risks of tomorrow. (Handal is a member of *Corporate Counsel's* editorial advisory board.)

McNulty, the former deputy AG, agrees that some companies get the message and are engaging in more self-policing. The downturn in shareholder suits, he says, suggests that there is better compliance occurring on the front end.

But he doesn't see prosecution agreements or monitors disappearing anytime soon. In fact, he predicts that their use will continue to grow, especially in this era of globalization. "We're ensuring the safety and soundness of our marketplace" to the world, McNulty says.

Handal seconds that sentiment. In some ways, he says, the appointment of a monitor "was the best thing that could have happened to us." Some general counsel may be surprised at what Handal says next: "I encourage the government to use more of them." ■