

# DEFERRED PROSECUTION AGREEMENTS: PROSECUTORIAL BALANCE IN TIMES OF ECONOMIC MELTDOWN

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## ABSTRACT

*At times when the American economy faces enormous challenges, traditional prosecutorial measures that involve high public spending and immense collateral risks may hamper economic recovery. Economic meltdowns, such as the one we have been experiencing in recent years, call for a refreshment of the prosecutorial toolkit aimed at controlling corporate misconduct. This paper discusses the newly emerged enforcement mechanism, Deferred Prosecution Agreements (DPAs), in light of the current national goal of economic recovery. It portrays the evolution of DPAs and the stimulus for its expansion that followed recent Corporate America scandals. Based on the evaluation of the major promises and pitfalls of DPAs, it is suggested that subject to some policy adjustments, an expanded use of DPAs as an alternative for traditional prosecutorial measures may coincide with economic recovery goals.*

**Keywords:** Economic meltdown, recession, Deferred Prosecution Agreements, corporate compliance, deterrence, enforcement policy, collateral effects, enforcement, economic recovery

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**TABLE OF CONTENTS**

**INTRODUCTION.....67**

**I. ENFORCEMENT CHALLENGES IN TIMES OF ECONOMIC  
MELTDOWN .....68**

**II. DEFERRED PROSECUTION AGREEMENTS (DPAS) .....69**

A. DPAS - WHAT IS IT ALL ABOUT?.....69

B. THE EVOLUTION OF DEFERRED PROSECUTION IN THE CORPORATE  
ARENA ..... 70

C. CORPORATE MONITORS ..... 76

**III. POLICY EVALUATION .....79**

A. THE PROMISES OF DPAS IN TIMES OF ECONOMIC MELTDOWN .....79

B. THE PITFALLS OF EXISTING DPAS POLICIES .....82

**IV. EMERGING DPAS POLICIES .....85**

**V. CONCLUSIONS.....90**

## INTRODUCTION

The economic meltdown of the past three years has taken its toll on almost every aspect of American life. Ever since the liquidity shortfall in the United States banking system in 2007 triggered the Great Recession, numerous businesses have lost a substantial fraction of their value; some could not escape shutting down their businesses; others are still struggling to survive the economic turmoil through severe budget cuts and unavoidable business compromises. Experts debate over the causes of the financial crisis and whether the worst of the economic turmoil is behind us.<sup>1</sup> Most commentators agree that although first signs of recovery have started appearing, the United States has a long way to full economic recovery. This view has spurred the recent promulgation of several policies aimed at coping with the ramifications of the economic depression, boosting the economy, and stimulating its growth.<sup>2</sup> This paper joins the growing body of scholarly literature proposing outlets from the recession through recovery-stimulating policy reforms. It addresses the particular policy niche of controlling corporate misconduct in times of economic meltdown, and discusses Deferred Prosecution Agreements (DPAs)—an enforcement instrument that has gained great significance throughout the last decade, and may develop into an invaluable enforcement instrument in current times of economic meltdown.

This paper is structured as follows: Section I describes the unique challenges faced by public enforcement authorities in times of economic meltdown. Section II provides a general overview of the newly emerged enforcement policy, DPAs. This overview surveys the evolution of this mechanism in U.S. enforcement policy, and portrays the common features of DPAs as developed in practice. Special attention is paid to an innovative feature of many DPAs, namely, corporate monitors whose appointments have occasionally been required by the Department of Justice (DOJ) to ensure corporate compliance with the terms of DPAs. Next, Section III evaluates the unique promises of DPAs as an alternative to traditional corporate prosecution in times of economic meltdown. Furthermore, this section points out some important pitfalls that may require some policy adjustments when utilizing DPAs in practice. Some recent attempts to regulate the use of DPAs and cope with these pitfalls are discussed in Section IV. Finally, Section V provides a summary and concludes that recent policy developments concerning DPAs seem to pave the

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<sup>1</sup> For a general overview of the recent financial crisis and its underlying causes see Richard A. Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (USA: Harvard Univ. Press, 2009).

<sup>2</sup> New laws signed recently by the U.S. President include the American Recovery and Reinvestment Act of 2009, which has been responsible for millions of American jobs; Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, which aims at holding Wall Street more accountable than it was before; the Small Business Jobs Act of 2010, that provides tax breaks and better access to credit for small businesses; the Fraud Enforcement and Recovery Act of 2009, which expands the federal government toolkit with respect to investigation and prosecution of frauds.

way for a socially desirable utilization of this enforcement mechanism in the future to come.

## I. ENFORCEMENT CHALLENGES IN TIMES OF ECONOMIC MELTDOWN

Economically distressed times are often associated with an increase in white-collar crime.<sup>3</sup> This phenomenon may have various causes.<sup>4</sup> At the outset, forced budget cuts may dilute corporate internal compliance and monitoring actions, thereby increasing incidents of non-compliance.<sup>5</sup> Similarly, businesses facing financial difficulties may be more concerned about short-term consequences of their actions than middle- or long-term ones. Executives as well as employees of financially distressed corporations know that if earning targets are not met, they may simply lose their jobs. Consequently, such corporate actors may look for quick fixes, and thereby may succumb to a temptation to engage in questionable practices, and even deliberately commit crimes. On top of that, budget-cuts faced by enforcement authorities may lead to under-deterrence and encourage law-breaking among business corporations.<sup>6</sup>

A typical policy response to increased non-compliance is an acceleration of enforcement activities by enforcement authorities, including closer monitoring, stricter prosecution policy, and more rigorous penalty schemes. Such a response is supported by the deterrence theory, according to which crime rates fall in proportion to the severity and in the probability of punishment.<sup>7</sup> Yet, in times of economic meltdown, such a typical re-

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<sup>3</sup> See Katie Allen, *Recession Pushes White-Collar Crime to New Highs*, GUARDIAN UNLIMITED, Dec. 31, 2009, <http://www.guardian.co.uk/business/2009/dec/31/fraud-recession-kpmg-report> (“Hard times have driven more people to investment scams and supply chain fraud.”); Ben Levisohn, *Experts Say Fraud Likely to Rise*, BLOOMBERG BUSINESSWEEK, Jan. 9, 2009, [http://www.businessweek.com/bwdaily/dnflash/content/jan2009/db2009018\\_753877.htm](http://www.businessweek.com/bwdaily/dnflash/content/jan2009/db2009018_753877.htm) (referring to Data from the National White Collar Crime Center, according to which “following the savings and loan crisis and the downturn in 1990, white-collar fraud arrests jumped 52% the next two years; following the Internet bust in 2000, arrests jumped 25% in the following two years.”); See also Marc Neff, *White-Collar Fraud Expected to Increase as Recessionary Economy Continues*, PHILADELPHIA CRIMINAL DEFENSE LAWYER BLOG, Jan. 16, 2009, <http://www.philadelphiacriminaldefenselawyerblog.com/> (The linkage between economic downturns and non-compliance has been established in the literature focusing on tax compliance). See e.g., John Brondolo, *Collecting Taxes during an Economic Crisis: Challenges and Policy Option*, INT’L MONETARY FUND (2009), at 6, available at, <http://www.imf.org/external/pubs/ft/spn/2009/spn0917.pdf> (“the balance of evidence, as set out above, suggests that compliance could reasonably be expected to decline during the ongoing crisis”); Alan H. Plumley, *The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE (1996), at 20, available at <http://www.irs.gov/pub/irs-soi/pub1916b.pdf> (“a high unemployment rate is likely to cause taxpayers to become less compliant; to the extent that they have less disposable income, they are more likely to cut corners on their taxes—or maybe not even file at all.”); Hongbin Cai & Qiao Liu, *Competition and Corporate Tax Avoidance: Evidence from Chinese Industrial Firms*, 119 ECON. J., 764 (2009) (shows that corporate income tax is negatively correlated with access to credit).

<sup>4</sup> See Ellen S. Podgor, *White-Collar Crime and the Recession: Was the Chicken Or Egg First?* The University of Chicago Legal Forum 2010 (2010), 205-222; *Id.*; Neal Shover and Peter Grabosky, *White-Collar Crime and the Great Recession*, *Criminology and Public Policy* 9(3) (2010), 429, opening a special issue of *Criminology & Public Policy* dealing with white-collar crime and the Great Recession.

<sup>5</sup> See Beth Kampschorr, *Financial Crisis Benefits Crime*, ORGANIZED CRIME AND CORRUPTION REPORTING PROJECT (20 March, 2009) (“a rocky economy means police budgets are being slashed in the US and elsewhere, paving the way for more crime to flourish.”)

<sup>6</sup> See Neal Shover & Peter Grabosky, *White-Collar Crime and the Great Recession*, 9 CRIMINOLOGY & PUB. POL’Y, 431 (2010) (“a widely shared perception that credible oversight is lacking transforms the supply of lure into a tide of criminal opportunities.”)

<sup>7</sup> The Deterrence Theory has been established by the Law and Economic literature, starting with the pioneering work by Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 (2) J. POL. ECON., 169 (1968). It has been

sponse encounters two major hurdles. First, as implied earlier, enforcement authorities may lack the resources required to meet the increased demand for enforcement activities.<sup>8</sup> In that respect, accelerated enforcement is simply not feasible. Second, accelerated enforcement activity may hamper economic recovery by imposing collateral consequences on investors, creditors, and employees. Hence, in times of economic meltdown, policy-makers may seek a refreshment of the enforcement policy to sensibly balance deterrence goals and collateral risks, while considering existing budget concerns. The following section describes a newly emerged enforcement mechanism – Deferred Prosecution Agreements (DPAs)—which may be useful to cope with the aforementioned challenges, and thus be particularly invaluable in times of economic meltdown.

## II. DEFERRED PROSECUTION AGREEMENTS (DPAs)

### *a. DPAs - What are they all about?*

Until recently, U.S. prosecutors have held a single weapon against culpable corporations: they could bring criminal charges against corporations and their top functionaries.<sup>9</sup> The use of this powerful weapon has always required prosecutors to consider the considerable enforcement cost involved, as well as the substantial collateral consequences that such procedures may have on other stakeholders such as the shareholders, employees, and consumers. A notable example of potential collateral effects of criminal proceedings is the famous case of Arthur Andersen. Then amongst the world's largest accounting firms (more than 85,000 employees), Arthur Andersen imploded after being convicted by the United States District Court for the Southern District of Texas for its failure to fulfill professional responsibilities in auditing Enron's financial statements. By the time the Supreme Court overturned the indictment in 2005, the damage to the company was irreversible and the company was driven out of business.<sup>10</sup> Arthur Andersen's case has accentuated the need to consider real-world consequences that corporate indictments may have and stimulated the further development of the new policy instrument, known as Deferred Prosecution Agreements (DPAs). DPAs comprise a wide variety of agreements between the prosecution and culpable corporations, under which prosecutors agree to defer the

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elaborated by others, including George J. Stigler, *The Optimum Enforcement of Laws*, 78 J. POL. ECON., 526 (1970); John R. Harris, *On the Economics of Law and Order*, 78 J. POL. ECON., 165 (1970); Isaac Ehrlich, *Participation in Illegitimate Activities: A Theoretical and Empirical Investigation*, 81 J. POL. ECON., 521 (1973); Isaac Ehrlich, *The Deterrent Effect of Capital Punishment: A Question of Life and Death*, 65 AM. ECON. REV., 397 (1975); Isaac Ehrlich & Mark Randall, *Fear of Deterrence: A Critical Evaluation of the Report of the Panel on Research on Deterrent and Incapacitative Effects*, 6 J. LEGAL STUD. 293 (1977); Isaac Ehrlich, *Crime, Punishment, and the Market for Offenses*, 10 J. ECON. PERSP. 43 (1996).

<sup>8</sup> See e.g., Ross Colvin, *U.S. Recession Fuels Crime Rise, Police Chiefs Say*, REUTERS, Jan. 27, 2009 ("Police chiefs in the United States say the economic downturn is fueling a rise in crime and warn that cuts to their budgets could handcuff their efforts to tackle it.").

<sup>9</sup> See James K. Robinson, Phillip E. Urofsky & Christopher R. Pantel, *Deferred Prosecutions and the Independent Monitor*, 2 INT'L J. DISCLOSURE AND GOVERNANCE 333, 326 (2005); Eugene Illovsky, *Corporate Deferred Prosecution Agreements: The Brewing Debate*, 21 CRIM. JUST., 36 (2006).

<sup>10</sup> See *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005). Andersen's case is further discussed in section III.a below.

prosecution of culpable corporations if these corporations fulfill their obligations to undertake dictated structural reforms and to comply with certain standards of behavior.<sup>11</sup>

Although the specific content of DPAs may substantially differ from one agreement to another, in most cases, such agreements include the following components: (a) Corporate commitment to pay a combination of a criminal fine, civil penalty, and restitution; (b) Corporate obligation to cooperate with ongoing investigations; and (c) Corporate commitment to adopt a preapproved compliance management system that is designed to ensure compliance with the agreement and disrupt misconduct.<sup>12</sup> On top of that, many DPAs require corporations to appoint an independent corporate monitor that is empowered to oversee the corporate compliance management system and ensure that the corporation follows the agreement.<sup>13</sup> The average period of DPAs is three years.<sup>14</sup> If the corporation fulfilled its obligations, the prosecutor would dismiss all charges against the corporation for the specific misconduct associated with the agreement. However, if the corporation failed to fulfill its obligations, the prosecutor would request the court to continue with the deferred charges against the corporation.<sup>15</sup> To avoid the risk of losing evidence or witnesses due to the postponement of charges, DPAs regularly require corporations to admit to substantial facts that may ground a conviction in case they breach such agreements.<sup>16</sup>

#### *b. The Evolution of Deferred Prosecution in the Corporate Arena*

Deferred prosecution is not an entirely new policy instrument. In fact, the origins of this instrument can be traced back to the beginning of the twentieth century, when deferred prosecution began being used as an alternative enforcement arrangement designed to promote juvenile and drug offenders' rehabilitation.<sup>17</sup> The idea behind the develop-

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<sup>11</sup> See Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095 (2006); Robinson, Urofsky & Pantel, *supra* note 9, at 325; Scott A. Resnik & Keir N. Dougall, *The Rise of Deferred Prosecution Agreements*, N. Y. L.J.: Sec. Liti. & Reg. (December 18, 2006); Peter Spivack & Sujit Raman, *Regulating the 'New Regulators': Current Trends in Deferred Prosecution Agreements*, 45 AM. CRIM. L. REV. 159 (2008). In some cases, the agreement between the prosecution and the corporations is reached before criminal charges are brought to the court against the corporation. Such agreements, called Non-Prosecution Agreements (NPAs) postpone the filing of criminal charges against corporations, provided that they adhere to the terms of the agreement. In this paper I do not distinguish between DPAs and NPAs except when otherwise noted.

<sup>12</sup> See e.g., Gibson Dunn, *2009 Year-End Update on Corporate Deferred Prosecution and Non-Prosecution Agreements*, Jan. 7, 2010, available at <http://www.gibsondunn.com/publications/pages/2009Year-EndFCPAUpdate.aspx>.

<sup>13</sup> See e.g., Robinson, Urofsky & Pantel, *supra* note 9, at 325; Benjamin M. Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863 (2005); Illovsky, *supra* note 6, at 36; Kathleen M. Boozang & Simone Handler-Hutchinson, *"Monitoring" Corporate Corruption: DOJ's use of Deferred Prosecution Agreements in Health Care*, 35 AM. J.L. & MED. 89 (2009). The use of corporate monitors in DPAs is further discussed in Subsection II.C below.

<sup>14</sup> See Gibson Dunn, *2008 Year-End Update on Corporate Deferred Prosecution and Non-Prosecution Agreements*, Jan. 6, 2009, available at <http://www.gibsondunn.com/publications/pages/2008Year-EndUpdate-CorporateDPAs.aspx>; Vikramaditya S. Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar*, 105 MICH. L. REV. 1713 (2007); Dunn, *supra* note 9.

<sup>15</sup> See Greenblum, *supra* note 10, at 1863; Gibson Dunn, *supra* note 12; Gibson Dunn, *2009 Mid-Year Update on Corporate Deferred Prosecution and Non-Prosecution Agreements* (July 8, 2009), available at <http://www.gibsondunn.com/publications/Pages/2009Mid-YearUpdate-CorpDeferredProsecutionAgreements.aspx>.

<sup>16</sup> See Robinson, Urofsky & Pantel, *supra* note 9, at 325; Illovsky, *supra* note 6, at 37.

<sup>17</sup> The birth of deferred prosecution arrangement is attributed to the Chicago Boys' Court that has initially con-

ment of this instrument was to minimize the potentially harsh consequences of criminal convictions. Policymakers sought to avoid the stigmatization of nonviolent first-time offenders who were not yet committed to “criminal careers.”<sup>18</sup> In 1975, DPAs were recognized as an official policy instrument by the U.S. Congress, which established special pretrial agencies to assist judges in determining offenders’ suitability to the newly created rehabilitation programs and to supervise those offenders during the deferral period.<sup>19</sup> Eventually, the DOJ promulgated unified eligibility criteria and procedures through an official Pretrial Diversion Program as part of the U.S. Attorney’s Manual.<sup>20</sup> This program was specifically designed for individual offenders, and did not apply to corporate crime.<sup>21</sup>

The adoption of DPAs into the corporate arena was a gradual process that started with a handful of cases during the 1990s. The initial step was a NPA reached in the *Salomon Brothers* case in 1992.<sup>22</sup> In this case, a ten-month multi-agency investigation led to several allegations against Salomon Brothers, according to which the company had submitted false and unauthorized bids in violation of federal forfeiture laws and the False Claims Act, and that the company and others entered into unlawful agreements with respect to trading in financing and secondary markets in violation of the Sherman Antitrust Act.<sup>23</sup> Nevertheless, the DOJ agreed to seek no criminal charges against Salomon Brothers with respect to these matters in exchange for Salomon Brothers’ commitment to pay \$290 million in sanctions, forfeitures, and restitution.<sup>24</sup> In addition, the settlement required Salomon Brothers to continue its cooperation with various government investigations and to institute a compliance management system to prevent reoccurrence of violations.<sup>25</sup> In ex-

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ceived deferred prosecution in 1914. *See e.g.*, David A. Inness, *Developments in the Law: Alternatives to Incarceration*, 111 HARV. L. REV., 1863 (1998); James A. Inciardi et al., *Drug Control and the Courts* (U.S., SAGE Publications Inc) (1996); Greenblum, *supra* note 10, at 1863; Robinson, Urofsky & Pantel, *supra* note 9, at 325. The use of deferred prosecution has extended to drug offenders in 1962 by the Supreme Court’s ruling in *Robinson v. California*, 370 U.S. 660, 667 (1962). *See* Lisa Rosenblum, *Mandating Effective Treatment for Drug Offenders*, 53 HASTINGS L.J. 1217 (2001); Andrew Armstrong, *Drug Courts and the De Facto Legalization of Drug use for Participants in Residential Treatment Facilities*, 94 J. CRIM. L. & CRIMINOLOGY 133 (2003); Greenblum, *supra* note 10, at 1886; Robinson, Urofsky & Pantel, *supra* note 9 at 326.

<sup>18</sup> *See* Robert W. Balch, *Deferred Prosecution: The Juvenilization of the Criminal Justice System*, 38 FED. PROBATION 46 (1974); Greenblum, *supra* note 10, at 1886; GENNARO F. VITO & DEBORA G. WILSON, *THE AMERICAN JUVENILE JUSTICE SYSTEM* (U.S., Sage Publications, Inc. 1985).

<sup>19</sup> *See e.g.*, Barry Mahoney et al., *Pretrial Services Programs: Responsibilities and Potential*, U.S. DEP’T OF JUSTICE, OFFICE OF JUSTICE PROGRAMS, NATIONAL INSTITUTE OF JUSTICE (2001); Greenblum, *supra* note 10, at 1867.

<sup>20</sup> *See* U.S. Attorneys’ Manual (1997) (“Attorney’s Manual”), § 9-22.000, available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/22mcrm.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/22mcrm.htm). The Pretrial Diversion Program is described in § 9-22.010 as “an alternative to prosecution which seeks to divert certain offenders from traditional criminal justice processing into a program of supervision and services administered by the U.S. Probation Service. In the majority of cases, offenders are diverted at the pre-charge stage. Participants who successfully complete the program will not be charged or, if charged, will have the charges against them dismissed; unsuccessful participants are returned for prosecution.”

<sup>21</sup> *See* F. Joseph Warin & Jason C. Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, 23 J. CORP. L. 121, 129-30 (1997).

<sup>22</sup> *See* Department of Justice, *Press Release: Department of Justice and SEC Enter \$290 Million Settlement with Salomon Brothers in Treasury Securities Case*, (May 20, 1992). For the definition of NPAs see *supra* note 11.

<sup>23</sup> *See* Department of Justice, *Press Release: Department of Justice and SEC Enter \$290 Million Settlement with Salomon Brothers in Treasury Securities Case* (May 20, 1992), available at [http://www.justice.gov/atr/public/press\\_releases/1992/211182.htm](http://www.justice.gov/atr/public/press_releases/1992/211182.htm).

<sup>24</sup> *See Id.*

<sup>25</sup> *See Id.*; Greenblum, *supra* note 10, at 1872; Warin & Schwartz, *supra* note 18, at 125; William K. Perry &

plaining its decision to refrain from criminal charges, the DOJ mainly relied on Salomon Brothers' "exemplary" cooperation, due to which "there [was] no need for invoking the criminal process."<sup>26</sup>

Shortly after the Salomon Brothers' case, in June 1993, the U.S. Attorney for the Southern District of New York reached an agreement with Sequa Corporation.<sup>27</sup> According to this agreement the U.S. Attorney agreed to refrain from prosecuting Sequa and its subsidiary for fraud in the manufacture and repair of airplane engine parts, in exchange for Sequa's commitment to pay \$5 million for scientific testing and expert analysis of airplane parts.<sup>28</sup> In addition, Sequa agreed to managerial changes and committed to continue its cooperation with the investigation.<sup>29</sup> Similarly to the Salomon Brothers' case, the U.S. Attorney considered Sequa's cooperation with the investigation and the potential collateral effect of criminal charges against the corporation, including the harm that may be suffered by Sequa's employees and customers.<sup>30</sup>

The next important stepping stone in setting the grounds for DPAs as a legitimate enforcement mechanism was the 1994 *Prudential Securities* case.<sup>31</sup> Prudential was charged with securities fraud related to the sale of some oil and gas limited partnerships. The allegations against Prudential included investor deception regarding the returns and tax status of the investments.<sup>32</sup> The U.S. Attorney for the Southern District of New York agreed to enter into a DPA with Prudential.<sup>33</sup> Per the DPA, the charges against Prudential would be *deferred* in exchange for Prudential's commitment to pay \$330 million in restitution.<sup>34</sup> Similar to the prior cases, the offender's cooperation with the government investigation and the concerns of collateral consequences on its employees and investors set the ground for the deferral. Unlike the previous cases, though, Prudential's DPA did not simply dismiss the charges against Prudential, but rather *deferred* them for a period of three years, after which, provided that Prudential has complied with the terms of the agreement and avoided additional misconduct, the criminal charges were to be dismissed. Under the specific circumstances of Prudential's DPA, if Prudential failed to comply with the agreed conditions or engaged in wrongdoing during that period, all charges against Prudential

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Linda S. Dakin, *Compliance Programs and Criminal Law*, in *Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability* 22.13 (Jefferey M. Kaplan & Joseph E. Murphy eds., Revised ed. 2009).

<sup>26</sup> See Department of Justice, *Press Release: Department of Justice and SEC Enter \$290 Million Settlement with Salomon Brothers in Treasury Securities Case*; Warin & Schwartz, *supra* note 18, at 124; Greenblum, *supra* note 10, at 1872.

<sup>27</sup> See United States Attorney's Office, *Announcement of Decision Not to Prosecute Sequa Corporation* (June 24, 1993); reprinted in *Press Releases Issued by United States Attorney, Southern District of New York*, 1248 PLI/Corp. 197, 211-14 (2001).

<sup>28</sup> See Warin & Schwartz, *supra* note 18, at 125.

<sup>29</sup> See *Id.*

<sup>30</sup> See *Id.* at 125. See also Corporate Crime Reporter, *Crime without Conviction: The Rise of Deferred and Non Prosecution Agreements*, available at <http://www.corporatecrimereporter.com/deferredreport.htm>, Corp. Crime Reporter (December 28, 2005).

<sup>31</sup> Deferred Prosecution Agreement, *United States v Prudential Securities Incorporated* (S.D.N.Y. Mag. # 94-2189), dated 27 October, 1994; available at <http://www.corporatecrimereporter.com/documents/prudential.pdf>

<sup>32</sup> See Greenblum, *supra* note 10, at 1873; Robinson, Urofsky & Pantel, *supra* note 9, at 329; Warin & Schwartz, *supra* note 18, at 125-6.

<sup>33</sup> See Deferred Prosecution Agreement, *United States v Prudential Securities Incorporated*, *supra* note 31.

<sup>34</sup> See *Id.*

would resurrect.<sup>35</sup> To assure Prudential's abidance, the DPA further required the company to employ an independent law firm to serve as a corporate monitor to review its regulatory and compliance controls.<sup>36</sup> This "probation period" became an inherent feature of all subsequent DPAs.<sup>37</sup>

In 1996, the U.S. Attorney for the Central District of California reached an agreement with Cooper & Lybrand.<sup>38</sup> The partnership was accused of concealing essential errors and omissions in the Arizona Governor's financial statements, as well as of receiving inside information regarding a state contract. The U.S. Attorney considered the "exemplary cooperation" of Cooper & Lybrand with the investigation and entered into an NPA with the partnership.<sup>39</sup> According to the agreement, the prosecution was to be deferred for a two-year period.<sup>40</sup> In exchange, the partnership committed to pay additional \$3 Million for restitution; to employ an independent corporate monitor to ensure corporate compliance; and to implement a compliance management system that would include a nationwide ethics and integrity training for its professionals.<sup>41</sup> This agreement further extended the scope of DPAs by conceiving an *extrajudicial adjudicatory process*, under which the prosecutors were authorized to impose a \$100,000 fine for any breach of the agreement that they chose not to prosecute, without any judicial intervention.<sup>42</sup>

As mentioned above, the Pretrial Diversion Program that was incorporated into the U.S. Attorneys' Manual (1997) set forth the criteria for deferred prosecution with respect to individuals.<sup>43</sup> However, when corporations were concerned, prosecutors who decided to use DPAs exercised wide discretion in designing and implementing such agreements.<sup>44</sup> In a nod to the emerging practices, Eric Holder, then-U.S. Deputy Attorney General,

<sup>35</sup> See Letter from Kenneth J. Vianale and Baruch Weiss, Ass't US Atty's for the S. Dist. of N.Y., U.S. Dep't of Justice to Scott W. Muller & Carey R. Dunne, Davis Polk & Wardwell, counsel to Prudential Sec., Inc. (Oct. 17, 1994), p. 3; available at <http://www.corporatecrimereporter.com/documents/prudential.pdf>.

<sup>36</sup> See *Id.* ("It is further understood that [Prudential] shall: ... (b) comply with all the terms and conditions of the SEC agreement and retain a mutually acceptable outside counsel within 30 days of the filing of this agreement to review [Prudential]'s policies and procedures in order to ensure that [Prudential] has adopted all the compliance-related directives set forth in the SEC agreement."); See Pery & Dakin, *supra* note 20, at 22.14; Robinson, Urofsky & Pantel, *supra* note 9, at 329; Greenblum, *supra* note 10, at 1873; Warin & Schwartz, *supra* note 18, at 125-6.

<sup>37</sup> It should be noted that 'corporate probation' was acknowledged even before *Prudential Securities* case by the Organizational Sentencing Guidelines (OSG) as an appropriate measure that can be used against culpable corporations. However, the use of probation measures was meant as part of the sentence, *i.e.*, after the corporation was convicted. See the United States Sentencing Commission (USSC), *Federal Sentencing Guidelines Manual: Chapter Eight - Sentencing of Organizations* (2009), available at <http://www.ussc.gov/2007guid/CHAP8.pdf> ("probation is an appropriate sentence for an organizational defendant when needed to ensure that another sanction will be fully implemented, or to ensure that steps will be taken within the organization to reduce the likelihood of future criminal conduct.")

<sup>38</sup> Coopers & Lybrand LLP (C&L), *Settlement Agreement* (C.D. Cal. 1996); See Corporate Crime Reporter, *Crime without Conviction: The Rise of Deferred and Non Prosecution Agreements*, Dec. 28, 2005, available at <http://www.corporatecrimereporter.com/deferredreport.htm>.

<sup>39</sup> See *Id.*

<sup>40</sup> See *Id.*

<sup>41</sup> See *Id.*; See also Warin and Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, pp. 126-7.

<sup>42</sup> See Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1873; Warin and Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, p. 127.

<sup>43</sup> See *supra* notes 20 - 21 and the related text.

<sup>44</sup> See Resnik & Dougall, *supra* note 11.

promulgated a memorandum that laid down unified criteria, composed of eight factors that should be considered when deciding whether to bring charges against corporations (“Holder Memo”):<sup>45</sup> (1) The nature and seriousness of the offense; (2) The pervasiveness of wrongdoing within the corporation; (3) The corporation's history of similar conduct; (4) The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation; (5) The existence and adequacy of the corporation's compliance program; (6) The corporation's remedial actions; (7) Collateral consequences; and (8) The adequacy of non-criminal remedies.<sup>46</sup> Although the Holder Memo did not explicitly acknowledge DPAs as formal prosecutorial instruments, the first signs of their recognition as a legitimate enforcement instrument can be seen in the commentary §VI(B) of the holder Memo: “[A] corporation's cooperation may be critical in identifying the culprits and locating relevant evidence. In some circumstances, therefore, *granting a corporation immunity or amnesty may be considered in the course of the government's investigation.*”<sup>47</sup>

Enron's scandal, which was exposed in 2001, shortly after the promulgation of the Holder Memo, propelled the issue of corporate controls and the desirability of DPAs to the front of the corporate governance polemic.<sup>48</sup> In 2003, DPAs gained substantial support by a new memorandum issued by the U.S. Attorney General, Larry D. Thompson (“Thompson Memo”).<sup>49</sup> The Thompson Memo reinforced—and slightly revised—the factors established by the Holder Memo for prosecution of business corporations. The major contribution of the Thompson Memo was its great emphasis of the *authenticity of corporations' proffered cooperation* as a major factor that should be taken into consideration when considering prosecution of corporations.<sup>50</sup> In addition, the Thompson Memo explicitly acknowledged the possibility of prosecution deferral in exchange for corporate genuine cooperation.<sup>51</sup>

Figure 1: Number of DPAs and NPAs Entered into by the DOJ over the Last Decade<sup>52</sup>

<sup>45</sup> See Holder, Eric, Deputy Attorney General, *Memorandum for Heads of Department Components United States Attorneys: Principles of Federal Prosecution of Corporations* (June 16, 1999).

<sup>46</sup> See *Id.*

<sup>47</sup> See *Id.*, commentary §VI(B) (emphasis added).

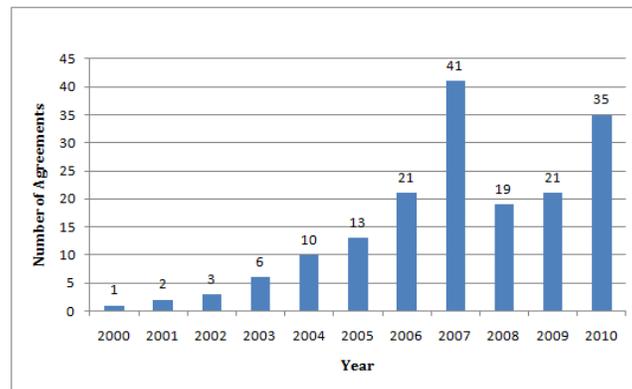
<sup>48</sup> Some sources reported that even Arthur Andersen has negotiated a DPA with the DOJ, which eventually failed due to Andersen's refusal to accept the ongoing monitoring requirement of the DOJ. See Alan Vinegrad, *Deferred Prosecution of Corporations*, N.Y. L.J., 2003; Greenblum, *supra* note 10, at 1888; Dunn, *supra* note 8; Robert L. Bartley, *Andersen: A Pyrrhic Victory*, WALL ST. J., June 24, 2002, at A17; Beth A. Wilkinson & Alex Young K. Oh, *The Principles of Federal Prosecution of Business Organizations: A Ten-Year Anniversary Perspective*, 27 NYSBA Inside 8 (2009); Blank Rome LLP, *Keeping A Watchful Eye: Corporate Deferred Prosecution Agreements and the Selection of Corporate Monitors*, Mondaq Business Briefing (2008), available at: <http://www.encyclopedia.com/doc/1G1-180924380.html>; *Crime without Conviction: The Rise of Deferred and Non Prosecution Agreements*, Corporate Crime Reporter (December 28, 2005), available at: <http://www.corporatecrimereporter.com/deferredreport.htm>.

<sup>49</sup> See Thompson, Larry D., Deputy Attorney General, *Memorandum for Heads of Department Components United States Attorneys: Principles of Federal Prosecution of Business Organizations* (January 20, 2003).

<sup>50</sup> See *Id.*; Greenblum, *supra* note 10, at 1874-5.

<sup>51</sup> See Thompson, *supra* note 34, at §VI.A and B.

<sup>52</sup> Figure 1 is adapted from Gibson Dunn, *2010 Year-End Update on Corporate Deferred Prosecution and Non-Prosecution Agreement* (January 4, 2011), at 2, available at <http://www.gibsondunn.com/publications/Documents/2010Year-Epdatepdf>



Following the Thompson Memo, the use of DPAs substantially expanded.<sup>53</sup> This expansion has three key dimensions. First, DPAs have risen in number. As presented in Figure 1, only a handful of DPAs were entered into between 2000 and 2002. This number consistently increased in the following years, peaking at 41 agreements in 2007. A drop in the number of DPAs appeared in 2008-2009, in which 19 and 21 DPAs were entered into correspondingly. However, in 2010 the number of DPAs climbed to 32 agreements, the second-highest number in the short history of DPAs. Furthermore, 2011 is on track to have a comparable amount of DPAs as 2010, with 17 agreements reached so far in the first half of 2011.<sup>54</sup> Overall, DPAs have continued gaining significance in the past decade and have become an important instrument used to combat major corporate crimes.<sup>55</sup> Second, the spectrum in which DPAs have been used has expanded to include a wide range of legal areas, including healthcare, Foreign Corrupt Practices Act (FCPA), tax, accounting irregularities, and False Claims Act.<sup>56</sup> And, third, the DOJ is no longer the only enforcement authority that uses DPAs. In 2010 the U.S. Securities and Exchange Commission (SEC) officially recognized DPAs as a valid enforcement practice through

<sup>53</sup> The factors established by the Holder and Thompson Memoranda were highlighted once again in 2006 in a Memorandum issued by the Deputy Attorney General, Paul McNulty (“*McNulty Memo*”). See McNulty, Paul, Deputy Attorney General, *Memorandum for Heads of Department Components United States Attorneys: Principles of Federal Prosecution of Business Organizations* (December 12, 2006). The McNulty Memo repeats the consideration of the Holder / Thompson factors and adds new restrictions regarding prosecutors’ powers to require privileged information from companies.

<sup>54</sup> Slightly different numbers are reported by United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ’s use and Oversight of Deferred Prosecution and Non-Prosecution Agreements* (Statement of Eileen R. Larence, Director Homeland Security and Justice) (June 25, 2009), at 1, according to which the DOJ has entered into 3 agreements in 2002, and 41 agreements in 2007.

<sup>55</sup> See Greenblum, *supra* note 10, at 1875 (“since the dissemination of Thompson [Memorandum], no corporation has been charged in a major corporate fraud investigation outside a deferred agreement.”) Such agreements involve a wide spectrum of corporations, including American Express Bank International (a former subsidiary of American Express Company), Banco Popular, PNC, Merrill Lynch, Boeing, Bristol-Myers Squibb, British Petroleum, Chevron, Pfizer, Aktiebolaget (AB) Volvo, Wellcare Health Plans, UBS AG, KPMG, WorldCom, Credit Suisse First Boston (CSFB), AOL, Deutsche Bank, and Shell Nigeria. ABN Amro Bank entered into 3 agreements in 2002, and 41 agreements in 2007.

<sup>56</sup> See Khanna & Dickinson, *supra* note 14, at 719-201; Vikramaditya S. Khanna, *Reforming the Corporate Monitor? in Prosecutors in the Board Room: Using Criminal Law to Regulate Corporate Conduct* (Anthony S. Barkow & Rachel E. Barkow eds., forthcoming); Boozang & Handler-Hutchinson, *supra* note 10, at 89; Gibson Dunn, *supra* note 11; Gibson Dunn, *supra* note 12; Gibson Dunn, *supra* note 9.

the promulgation of the new “Cooperation Initiative,” which recognizes a set of enforcement instruments, including DPAs that may be used by the SEC to encourage greater cooperation by individuals and companies in SEC investigations.<sup>57</sup> Accordingly, on May 17, 2011 the SEC entered into the first DPA with Tenaris S.A. that was accused with violations of the FCPA.<sup>58</sup> Altogether, as a result of their gradual recognition as a legitimate enforcement practice, DPAs have become an important tool that expands the prosecutorial toolkit and provides an alternative means of controlling corporate misconduct.

### c. Corporate Monitors

An interesting enforcement mechanism that has been adopted in many DPAs includes the appointment of independent corporate monitors to monitor corporate compliance with the terms of DPAs entered into by incumbent corporations. Third-party monitors have been used in different enforcement contexts even before their embracement in DPAs. In fact, the roots of third-party monitors can be traced back to the “Special Masters” appointed by the English Chancery in the early sixteenth century.<sup>59</sup> A more recent form of corporate monitors was used in the U.S. during the 1980s as a result of the Racketeer Influenced and Corrupt Organizations (RICO) Act.<sup>60</sup> Civil actions under the RICO Act resulted in the appointment of court-appointed monitors.<sup>61</sup> The use of corporate monitors has extended gradually through the 1990s.<sup>62</sup> In the recent decade, the use of corporate monitors was recognized by the DOJ as valuable in ensuring the optimal functioning of internal corporate governance mechanisms, especially when limited resources or expertise hamper direct supervision by the DOJ.<sup>63</sup>

The use of corporate monitors in DPAs, including their selection and the determination of roles and responsibilities, was subject to prosecutors’ discretion.<sup>64</sup> Throughout the last decade, corporate monitors have become a standard feature in many DPAs.<sup>65</sup> After

<sup>57</sup> See the SEC announcement of the ‘Cooperation Initiative,’ available at <http://sec.gov/spotlight/enfcoopinitiative.shtml>. See also Gibson Dunn, *supra* note 37, at 7; Aguilar, *supra* note 40.

<sup>58</sup> See United States Attorney’s Office, *The Securities and Exchange Commission Today Entered into a Deferred Prosecution Agreement (DPA) with Tenaris S.A. in its First-Ever use of the Approach to Facilitate and Reward Cooperation in SEC Investigations*. (May 17, 2011); available at <http://www.sec.gov/news/press/2011/2011-112.htm>.

<sup>59</sup> See Khanna and Dickinson, *supra* note 14, at 1715; Khanna, *supra* note 51, at 226-248.

<sup>60</sup> The RICO Act is a U.S. Federal law that was enacted by section 901(a) of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922 (15 October 1970), codified as Chapter 96 of Title 18 of the United States Code, 18 U.S.C. § 1961 through 18 U.S.C. § 1968. This act aimed at fighting the Mafia by extending criminal penalties and a civil cause of actions for actions carries out as part of an ongoing criminal organization.

<sup>61</sup> See Khanna and Dickinson, *supra* note 14, at 1716-7.

<sup>62</sup> Among these cases, corporate monitors were included in the agreements achieved in the *Prudential Securities* and *Cooper & Lybrand* cases discussed above, see the main text related to *supra* notes 32-42. For a historical overview of corporate monitors, see *Id.*, pp. 1715-20.

<sup>63</sup> See United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ’s use and Oversight of Deferred Prosecution and Non-Prosecution Agreements* (Statement of Eileen R. Larence, Director Homeland Security and Justice), p. 19 (“When deciding whether a monitor was needed to help oversee the development or operations of a company’s compliance program, DOJ considered factors such as the availability of DOJ resources for this oversight, the level of expertise among DOJ prosecutors to monitor compliance in more technical or complex areas, and existing regulatory oversight.”)

<sup>64</sup> See e.g. Wilkinson and Oh, *The Principles of Federal Prosecution of Business Organizations: A Ten-Year Anniversary Perspective*, p. 9; Spivack and Raman, *Regulating the ‘New Regulators’: Current Trends in Deferred Prosecution Agreements*, p. 162.

<sup>65</sup> For an overview of various cases in which the appointment of corporate monitors was required by DPAs and NPAs see Gibson Dunn, *supra* note 14; Robinson, Urofsky and Pantel, *supra* note 9, at 333-5; Gibson Dunn, *supra*

obtaining a clear indication of wrongdoing, prosecutors require corporations to hire corporate monitors as part of their DPAs.<sup>66</sup> Although the appointment of corporate monitors stems from an agreement between the corporation and the prosecutor, corporations agree to the appointment of corporate monitors only to avoid indictment consequences.<sup>67</sup> According to this approach, if the corporation had a genuine and comprehensive compliance management system in place, corporate monitors would not be required.<sup>68</sup> Hence, from the government's perspective, the appointment of corporate monitors substitutes complex and costly prosecution proceedings, and may achieve future compliance without using confrontational measures that could achieve undesired ends.<sup>69</sup>

***What are the roles and responsibilities of corporate monitors under DPAs?***

Generally speaking, corporate monitors, who are paid by the appointing corporation<sup>70</sup> are appointed by corporations to oversee the internal compliance management systems of corporations; to establish new compliance management systems—when such systems do not exist or were proven to be poorly administered—to review the effectiveness of corporate internal controls; and to disrupt misconduct while ensuring that the conditions of the DPAs are fulfilled.<sup>71</sup> The monitor's specific powers are determined and specified in each DPA, and differ from one case to another, ranging from merely advisory powers to significantly more intrusive ones—including restructuring corporate internal processes and reporting any deviation from the desirable corporate behavior, both to the corporation and to the court.<sup>72</sup> For instance, in the case of AOL, who faced criminal allegations regarding securities fraud perpetrated by some, specific employees, the 2004 DPA specified limited reviewing powers of the corporate monitor.<sup>73</sup> Similarly, in the cas-

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note 15.

<sup>66</sup> See Khanna and Dickinson, *supra* note 14, at 1714, 1727.

<sup>67</sup> See *Id.*

<sup>68</sup> See Christopher M. Matthews, *Fraud Chief: Effective Compliance Programs can Prevent Monitors*, Main Justice: Politics, Policy and the Law (2010), available at <http://www.mainjustice.com/2010/05/24/fraud-section-chief-effective-compliance-programs-can-prevent-monitors/> (quoting the Criminal Fraud Section Chief, Denis McInerney: "If you have already established an excellent compliance program, then it will be less likely that we'll install a compliance monitor, which can come at some cost to the company."). See also Christopher M. Matthews, *Grindler Touts Importance of Compliance, but Doubts Linger*, Main Justice: Politics, Policy and the Law (2010), available at <http://www.mainjustice.com/2010/05/25/grindler-touts-importance-of-compliance-but-doubts-linger/>.

<sup>69</sup> See Khanna, *supra* note 51 at 226-248; Khanna and Dickinson, *supra* note 14, at 1721; Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 1863-1904.

<sup>70</sup> See Khanna and Dickinson, *supra* note 14, at 1723. Mostly, corporations have to bear the cost of corporate monitors in addition to the monetary payment agreed upon between the parties. An exceptional DPA, in that respect, is Sirchie Acquisition Company, LLC's, entered into in February 2010, according to which Sirchie was allowed to partially offset the cost of its corporate monitor against the fine imposed under the DPAs. See Gibson Dunn, *2010 Mid-Year Update on Corporate Deferred Prosecution and Non-Prosecution Agreements* [August 5, 2010].

<sup>71</sup> See United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ's use and Oversight of Deferred Prosecution and Non-Prosecution Agreements* (Statement of Eileen R. Larence, Director Homeland Security and Justice), p. 19.

<sup>72</sup> See Khanna and Dickinson, *supra* note 14, at 1724-6; Blank Rome LLP, *Keeping A Watchful Eye: Corporate Deferred Prosecution Agreements and the Selection of Corporate Monitors*.

<sup>73</sup> See Deferred Prosecution Agreement at §13, *United States v. America Online, Inc.*, No. 1:04 M 1133 (S.D.Va 2004), available at: <http://www.corporatecrimereporter.com/documents/aol.pdf> ("[...] The Monitor will undertake a special review of: the effectiveness of AOL's internal control measures related to its accounting for advertising and related transactions; the training related to these internal control measures; AOL's deal sign-off and approval procedures; and AOL's corporate code of conduct. AOL agrees to cooperate with the Independent Monitor.") (emphasis

es of InVision, Monsanto, and Titan, all of which were related to violations of the Foreign Corrupt Practices Act (FCPA), the corporate monitors were entrusted to “evaluate the effectiveness” of the companies’ FCPA compliance management systems.<sup>74</sup> Conversely, in other cases, the powers of the corporate monitor expand beyond review and evaluation. In the Micrus case, for instance, which also involved FCPA violations, the DPA stated that “[d]uring the monitor’s term, no amendments or changes will be made to the policies and procedures without the prior approval of the monitor.”<sup>75</sup> Similarly, in the KPMG case, which involved allegations of designing fraudulent tax shelters, the appointed corporate monitor was empowered with wide review and monitoring powers, not only concerning the compliance management system, but also concerning the “implementation and execution of personnel decisions regarding individuals who engage in or were responsible [. . .] for the illegal conduct described in the information and may require any personnel action, including termination, regarding any such individuals.”<sup>76</sup> Additionally, in this case, the corporate monitor was required to actively investigate and report any potential misconduct flags to the corporate compliance officer, and to recommend actions needed to secure compliance.<sup>77</sup> In other cases, such as CIBC, Micrus and InVision, the corporate monitors were required to file periodic reports to the agencies concerning the corporate compliance with the agreement, and to provide the agencies with any additional information about the corporations, as requested by the agencies.<sup>78</sup> In some cases, corporate monitors are extremely powerful and involved in all critical corporate decisions.<sup>79</sup> For instance, in the Bristol-Myers Squibb case, the board removed the CEO and the general counsel of the corporation based on the corporate monitor’s recommendation.<sup>80</sup>

#### *How are corporate monitors selected?*

The corporation, with varying levels of prosecutorial involvement, typically selects corporate monitors.<sup>81</sup> In some cases, such as in Monsanto and Micrus, the agreements allow the corporations to choose corporate monitors that are “acceptable” to the prosecution.<sup>82</sup> In other cases, such as in CIBC, the prosecution itself selects the monitor for the

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added).

<sup>74</sup> See Robinson, *supra* note 9, at 333.

<sup>75</sup> See Non Prosecution Agreement at §D.11, between United States and Micrus S.A., Feb. 28, 2005, *z* available at <http://www.justice.gov/criminal/fraud/fcpa/cases/micrus-corp/02-28-05micrus-agree.pdf>

<sup>76</sup> See Deferred Prosecution Agreement at §18, United States v. KPMG (August 26, 2005), *available at*: <http://www.justice.gov/usao/nys/pressreleases/August05/kpmgdpagmt.pdf>.

<sup>77</sup> See *Id.*

<sup>78</sup> See Robinson, *supra* note 9, at 333.

<sup>79</sup> See also, Jennifer O’Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, 1 BROOK. J. OF CORP., FIN. AND COM. LAW 89 (2006), describing WorldCom’s corporate monitor as the most powerful person in WorldCom, who was involved in every important corporate decision.

<sup>80</sup> See Deferred Prosecution Agreement with Bristol-Myers Squibb, June 13, 2005, *available at* <http://www.justice.gov/usao/nj/press/files/pdf/deferredpros.pdf>. See also Resnik, *supra* note 11.

<sup>81</sup> See United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ’s use and Oversight of Deferred Prosecution and Non-Prosecution Agreements* (Statement of Eileen R. Larence, Director Homeland Security and Justice), pp. 2, 23-7 (“For the DPAs and NPAs GAO reviewed, even though DOJ was not a party to the contracts between companies and monitors, DOJ typically selected the monitor, and its decisions were generally made collaboratively among DOJ and company officials.”) See also Blank Rome LLP, *Keeping A Watchful Eye: Corporate Deferred Prosecution Agreements and the Selection of Corporate Monitors*.

<sup>82</sup> See Deferred Prosecution Agreement at §9, United States v. Monsanto Company (January 6, 2005), *available at*: <http://www.corporatecrimereporter.com/documents/monsantoagreement.pdf>; See also Non Prosecution Agreement at §D.11 between United States and Micrus S.A. (February 28, 2005), *supra* note 75.

corporation.<sup>83</sup> In most cases, however, corporate monitors are selected from a small group of former enforcement officials, including former judges, prosecutors and regulatory officers that are perceived as trustworthy by all the parties to the DPA.<sup>84</sup> Until recently, corporate monitors were not required to meet any level of qualification or special expertise in the relevant regulatory field.<sup>85</sup> The following discussion illustrates how the selection and nomination process of corporate monitors has been greatly criticized by the general public and scholarly literature.

### III. POLICY EVALUATION

#### *a. The Promises of DPAs in times of Economic Meltdown*

Two unique virtues make DPAs an invaluable alternative to the traditional criminal proceedings against business corporations, particularly in times of economic meltdown. First and foremost, as implied earlier, DPAs allow for the mitigation of collateral consequences often associated with criminal indictment. As such, using DPAs as an alternative to traditional corporate prosecution coincides with economic recovery goals. More particularly, criminal indictment of business corporations commonly produces poor publicity that may generate moral obloquy and social disgrace; thereby discouraging potential consumers, trading partners, and investors from entering into any business contact with the convicted corporation.<sup>86</sup> Furthermore, if indicted, companies may face fundamental instability that results in a loss of market share, reputation harm, and a reduction of stock value.<sup>87</sup> In extreme cases, an indictment may also lead the entire corporation to collapse, leaving its investors, creditors, and former employees to bear the losses. Of course, these concerns are amplified in times of economic meltdown, when corporations face severe financial challenges.

The Arthur Andersen case, briefly mentioned above, is a striking example of the se-

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<sup>83</sup> See Robinson, Urofsky and Pantel, *supra* note 9, at 332; Gibson Dunn, *supra* note 14.

<sup>84</sup> See Khanna and Dickinson, *supra* note 14, at 1722; O'Hare, *The use of the Corporate Monitor in SEC Enforcement Actions*, p. 108. See also United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ's use and Oversight of Deferred Prosecution and Non-Prosecution Agreements (Statement of Eileen R. Larence, Director Homeland Security and Justice)*, p. 2: ("Monitor candidates were typically identified through DOJ or company officials' personal knowledge or recommendations from colleagues and associates.") See also, Blank Rome LLP, *Keeping A Watchful Eye: Corporate Deferred Prosecution Agreements and the Selection of Corporate Monitors*.

<sup>85</sup> See Khanna, *supra* note 51, at 226-248.

<sup>86</sup> See John T. Scholz, *Voluntary Compliance and Regulatory Enforcement*, LAW & POL'Y 6(4) (1984), p. 396; Kazumasu Aoki, Lee Axelrad and Robert A. Kagan, "Industrial Effluent Control in the United States and Japan," in *Regulatory Encounters*, Robert A. Kagan and Lee Axelrad eds. (Berkeley, Los Angeles, London: University of California Press, 2000), pp. 81-2.

<sup>87</sup> See F. Joseph Warin and Andrew S. Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, VA. L. REV. 93 (2007), p. 129. See also Robinson, Urofsky and Pantel, *supra* note 9, at 327, and Gibson Dunn, *supra* note 14 ("[the] consequences [of criminal conviction] can be especially harsh for corporations that operate in highly regulated industries. For example, a conviction for certain violations could result in a corporation losing its broker-dealer license, banking license, charter, or deposit insurance; being stripped of eligibility to be a government contractor; or being prohibited from participation in government healthcare programs.")

vere collateral impacts that criminal indictment may have, and therefore it is worth a detailed reminder.<sup>88</sup> In 2002, Arthur Andersen L.L.P., one of the largest and the most successful consulting firms in the world, was criminally convicted by the United States District Court for the Southern District of Texas for violations pertaining to its failure to fulfill professional responsibilities in auditing Enron's financial statements.<sup>89</sup> Prior to its conviction, Arthur Andersen L.L.P. had flourished, with annual revenue of more than \$9.3 billion, and more than 85,000 employees across the world (compared to Enron, with 20,000 employees).<sup>90</sup> This reality changed dramatically after Andersen's conviction. Given its conviction—and while the appeal was still pending—Arthur Andersen was required to surrender its Certified Public Accountants (CPA) license.<sup>91</sup> As a result, the firm gradually lost most of its clients.<sup>92</sup> Although in 2005, the *Arthur Andersen* verdict was unanimously overturned by the U.S. Supreme Court, the damage to the firm was irreversible—the partnership entirely lost its reputation and clients, all 28,000 U.S.-based employees lost their jobs, most non-U.S. practices were taken over by local firms, and the remaining assets of the partnership were divided.<sup>93</sup> *Arthur Andersen L.L.P.* simply vanished into thin air, and has not returned to operate in the market ever since.<sup>94</sup>

In contrast to traditional criminal procedures, DPAs allow enforcement authorities to attain deterrence goals through an alternative arrangement that is based on a cooperative resolution of past violations, rather than through a confrontational legal process. It provides corporations with an incentive to comply with the law, as well as to be proactive in ensuring compliance by their employees to avoid sanctions. In that respect, it is important to bear in mind that under U.S. federal law, corporations are held liable for crimes committed by their employees within the scope of employment, even if the crimes committed were against corporate policy and/or direct orders.<sup>95</sup> Under such a liability scheme, cor-

<sup>88</sup> See *supra* note 10 and the related main text.

<sup>89</sup> United States v. Arthur Andersen LLP, CRH 02-121 (S.D. Tex. Mar. 7, 2002) (Indictment).

<sup>90</sup> See John C. Jr Coffee, *Gatekeepers: The Professions and Corporate Governance* (New-York, USA: Oxford University Press, 2006), p. 18.

<sup>91</sup> See Gary M. Cunningham and Jean E. Harris, *Enron and Arthur Andersen: The Case of the Crooked E and the Fallen A*, GLOBAL PERSPECTIVES ON ACCOUNTING EDUCATION 3, 27-48 (2006).

<sup>92</sup> See Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1888.

<sup>93</sup> See Kurt Eichenwald, *Andersen Guilty in Efforts to Block Inquiry on Enron*, N.Y. TIMES (June 16, 2002), reporting that soon after the conviction, "Andersen informed the government that it would cease auditing public companies as soon as the end of August, effectively ending the life of the 89-year-old firm." See also Bartley, *Andersen: A Pyrrhic Victory*, A17, referring to Rusty Hardin, Andersen's trial counsel, after the indictment saying that Andersen would definitely file an appeal but that, although a successful appeal would remove a black mark from Andersen's reputation, it would have no meaningful effect on the firm, because the firm was closing its doors. See also Wilkinson and Oh, *The Principles of Federal Prosecution of Business Organizations: A Ten-Year Anniversary Perspective*, p. 9.

<sup>94</sup> See e.g., Gibson Dunn, *supra* note 14; Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1875; Howard H. Chang and David S. Evans, Post-Enron Responses to Possible Corporate Crime Have Created Climate of Fear, ALLBUSINESS (December 22, 2007). See also Linda Greenhouse, *Justices Reject Auditor Verdict in Enron Scandal*, N.Y. TIMES, June 1, 2005.

<sup>95</sup> Corporate vicarious liability is imposed on corporations for crimes committed by their employees within the scope of their employment, and at least in part with the motive of benefiting the corporation. For a general discussion of the existing framework of criminal corporate liability, see also Reinier Kraakman, Vicarious and Corporate Liability, in *Tort Law and Economics*, Michael Faure ed., 2nd. ed. (UK & U.S.A.: Edward Elgar, 2009), 669-681; Andrew Weissmann and David Newman, *Rethinking Criminal Corporate Liability*, INDIANA L. J. (Bloomington) 82 (2007), p. 412, 422; Vikramaditya S. Khanna, *Corporate Liability Standards: When should Corporations be Held Criminally Liable?* AM. CRIM. L. REV. 37 (2002), 1239; Roland Hefendehl, *Corporate Criminal Liability: Model Penal Code Section 2.07 and the Development in Western Legal Systems*, BUFFALO CRIM. L. REV. 4 (2000), 283-300; Kevin B. Huff, *The Role of Corporate Compliance Programs in Determining Corporate Criminal Liability: A Suggested Approach*,

porations may become involved in criminal investigations for accidental, inadvertent violations.<sup>96</sup> Given this expansive exposure to liability, it is invaluable that DPAs allow corporations to take the required actions to improve their corporate governance scheme, enhance internal monitoring and control—all without suffering from the rigorous consequences of an indictment. Those corporations that cooperate with the prosecution and meet their obligations, as per their DPA, are able to escape the painful consequences of criminal litigation and conviction. By contrast, recalcitrant corporations that enter into a DPA insincerely are brought to court to face the full rigor of criminal law. In actuality, most DPAs entered into in the last decade were respected and followed by the corporations and required no further criminal proceedings.<sup>97</sup> Altogether, DPAs may substantially alleviate *collateral effects* that may otherwise be suffered by investors, creditors, and employees.

Another virtue of DPAs that is invaluable in times of economic meltdown is the public cost-savings that results from pursuing a DPA rather than formal criminal proceedings. Criminal proceedings involve enormous public costs. The most obvious are the direct costs of prosecution agencies, administrative costs of the court system, and the costs involved in holding a trial—including evidence collection, expert opinions, and witness testimony.<sup>98</sup> In addition, criminal proceedings may involve indirect costs, such as alienation costs<sup>99</sup> and error costs.<sup>100</sup> The criminal system's inherent costs are particularly bur-

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COLUMBIA L. REV. 96 (1996), 1252-1298; Charles J. Walsh and Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save its Soul?* RUTGERS L. REV. 47 (1995), 605-689; Eric Colvin, *Corporate Personality and Criminal Liability*, CRIM. L. FORUM 6(1) (1995), 1-44; William S. Laufer, *Corporate Bodies and Guilty Minds: The Failure of Corporate Criminal Liability* (Chicago and London: The University of Chicago Press, 1994), 647; Philip A. Lacovara and David P. Nicoli, *Vicarious Criminal Liability of Organizations: RICO as an Example of a Flawed Principle in Practice*, ST. JOHN'S L. REV. 64 (1989), 725-778. This liability framework has been adopted by several U.S. state laws. See for instance, Christopher R. Green, *Punishing Corporations: The Food-Chain Schizophrenia in Punitive Damages and Criminal Law*, NEB. L. REV. 87 (2008), 197-269; Weissmann and Newman, *Rethinking Criminal Corporate Liability*, p. 423, f.n. 39 and the related text.

<sup>96</sup> See e.g., *New York Central & Hudson River Railroad v. United States*, 212 U.S. 481 (1909); *United States v. American Radiator & Standard Sanitary Corp.*, 433 F.2d 174, (3d Cir. 1970), p. 204-205; *Standard Oil Co. v. United States*, 307 F.2d 120, 127-8 (5th Cir. 1962); *United States v. Armour & Co.*, 168 F.2d 342, (3d Cir. 1947), pp. 343-344; *Egan v. United States*, 137 F.2d 369 (8th Cir. 1943).

<sup>97</sup> Notable exceptions are, first, the case of *FirstEnergy Corp.*, which reached a DPA to defer charges for misrepresentations to the Nuclear Regulatory Commission. The DOJ perceived that an insurance claim brought by FirstEnergy violated the DPA. However, the DOJ eventually took no real action because FirstEnergy dropped the claim. In the Aibel Group case, by contrast, the DOJ decided to revoke the DPA it entered to in 2007 with Aibel after it found that Aibel did not follow its commitments. Aibel agreed to a guilty plea and reached a new agreement which resembled the DPA, except for the requirement to employ an external corporate monitor. See Gibson Dunn, *2008 Year-End Update*, *supra* note 14.

<sup>98</sup> See for instance, Anthony Ogus and Carolyn Abbot, "Pollution and Penalties," in *An Introduction to the Law and Economics of Environmental Policy: Issues in Institutional Design*, Book Series: Research in Law and Economics, Timothy Swanson ed., Vol. 20 (UK: Emerald Group Publishing Limited, 2002), p. 505; and John T. Scholz, *Cooperation, Deterrence, and the Ecology of Regulatory Enforcement*, LAW AND SOC'Y REV. 18 (1984), p. 207.

<sup>99</sup> Given the cat-and-mouse type of game endorsed by criminal charges, violators may find it worthwhile to commit the violation (and gain the benefits associated with it), while bearing additional expenditures to cover tracks, and by doing so, reduce the expected sanction. See Arun S. Malik, *Avoidance, Screening and Optimum Enforcement*, RAND J. OF ECON. 21(3) (1990), 341-353; Anthony G. Heyes, *Making Things Stick: Enforcement and Compliance*, OXFORD REV. OF ECON. POL'Y 14 (1998), p. 18; Robert Innes, *Violator Avoidance Activities and Self-Reporting in Optimal Law Enforcement*, J.L. ECON. AND ORG. 17(1) (2001), 239-256. See also Scholz, *Cooperation, Deterrence, and the Ecology of Regulatory Enforcement*, p. 207, according to which a harsh enforcement style which leads to confronta-

densome at times when not only corporate America, but also enforcement authorities face severe budget cuts. The use of DPAs as an alternative for criminal proceedings may mitigate—and even eliminate—many of these enforcement costs.

*b. The Pitfalls of Existing DPAs Policies*

Despite their promises, DPAs have been subject to a growing criticism in scholarly literature. One central line of criticism, for instance, addresses the *lack of DOJ guidance*.<sup>101</sup> Until 2008, the DOJ issued no specific instructions as to the use of DPAs. Therefore, individual prosecutors held wide discretion in entering into such agreements.<sup>102</sup> Apparently, as shown by the GAO Report of 2009, the wide prosecutorial discretion led to an inconsistent use of DPAs, in which different U.S. attorneys as well as different sections within the DOJ varied substantially in the terms of these agreements.<sup>103</sup> A recent example is presented by the Tenaris S.A. case, in which the corporation entered into a DPA with the SEC and into an NPA with the DOJ, based on the same facts.<sup>104</sup> No particular reason has been brought by either authority to explain the inconsistency regarding the use of a DPA by one authority and an NPA by the other. Obviously, such inconsistency in the application of DPAs may present a major risk of *arbitrariness* and *inequality*, and makes it difficult for corporations to map themselves out a path to follow in case of a governmental

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tions might motivate corporations to evade because by doing so they minimize their regulatory costs; and Pinaki Bose, *Regulatory Errors, Optimal Fines and the Level of Compliance*, J. OF PUB. ECON. 56(3) (1995), 475-484, which develops a model, according to which high penalties can lead to the regulators' efforts to obstruct the enforcement process, including greater incentives to challenge the regulatory sanction in court.

<sup>100</sup> Beside the direct institutional and procedural costs, prosecution and sanctioning may involve error costs of both types; prosecuting or convicting an innocent person (type I error) or discharging a culpable one (type II error). Although procedural laws often employ various measures to reduce the probability of errors (such as standards of proof and evidence admissibility rules), error costs are unavoidable by-products of prosecutors' and courts' decisions. See Heyes, *Making Things Stick: Enforcement and Compliance*, p. 55; Mitchell A. Polinsky and Steven Shavell, *The Economic Theory of Public Enforcement of Law*, J. OF ECON. LIT., AM. ECON. ASS'N 38(1) (2000), p. 23.

<sup>101</sup> See for instance, Wilkinson and Oh, *The Principles of Federal Prosecution of Business Organizations: A Ten-Year Anniversary Perspective*, p. 9; Warin and Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, 121-134; Spivack and Raman, *Regulating the 'New Regulators': Current Trends in Deferred Prosecution Agreements*, p. 162.

<sup>102</sup> See for instance, Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 1863-1904; Gibson Dunn, *2008 Year-End Update*, *supra* note 14; Gibson Dunn, *2009 Mid-Year Update*, *supra* note 15. See also Warin and Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, 121-134, who underscore the need for guidance with respect to DPAs and NPAs in the corporate context. See also Greg Burns, "Corporations Avoid Criminal Cases," CHI. TRIB. (March 20, 2005) ("Other critics say that putting off a corporate prosecution can be appropriate, but they worry the guidelines are too loose, and judicial oversight too limited.") Burns also quotes Prof. John C. Coffee Jr., as saying "This is a major and largely unrecognized gear shift in the law since Arthur Andersen [...] It's probably a sensible thing to do, but it is too unstructured."

<sup>103</sup> See United States Government Accountability Office (GAO), *Corporate Crime: Preliminary Observations on DOJ's Use and Oversight of Deferred Prosecution and Non-Prosecution Agreements* (Statement of Eileen R. Larence, Director Homeland Security and Justice), p. 2 ("prosecutors differed in their willingness to use DPAs or NPAs. In addition, prosecutors' varying perceptions of what constitutes a DPA or NPA has led to inconsistencies in how the agreements are labeled.") See also Warin and Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, p. 125, 132, who compare the DPAs reached in *Shell* and *Bristol Mayers-Squibb* cases, and conclude that the appropriate guidance must be provided to prevent future inconsistencies in designing DPAs/NPAs.

<sup>104</sup> For the press release by the SEC see *Supra* note 58. For the press release by the DOJ see Department of Justice, *Tenaris S.A. Agrees to Pay \$3.5 Million Criminal Penalty to Resolve Violations of the Foreign Corrupt Practices Act* (May 17, 2011); available at: <http://www.justice.gov/print/PrintOut2.jsp>.

investigation.<sup>105</sup>

Another major criticism brought forth by the scholarly literature is the *overreach* of prosecutorial discretion embedded in DPAs.<sup>106</sup> Similarly to other plea agreements, DPAs are usually not a product of true negotiation between equally powered parties. In fact, given the substantial adverse impact that criminal proceeding may have on corporate reputation, corporations that are offered a DPA are *de facto* compelled to accept the conditions set forth by the prosecution.<sup>107</sup> Such powers may first and foremost raise a concern of *over-expansion of DPAs* even in cases that would not have triggered prosecution in the past.<sup>108</sup> Furthermore, given their wide discretion, prosecutors are using DPAs to induce corporations to undertake dramatic structural reforms without being subject to adequate judicial supervision.<sup>109</sup> In the same vein, commentators have pointed to the professional judgments involved in an efficient design of corporate compliance programs and suggested that prosecutors, who often lack the required expertise, should not impose any such structural reforms.<sup>110</sup> Instead, a civil regulatory authority that is more likely to have expertise should create reformation.<sup>111</sup> Others have suggested restricting the discretion of individual prosecutors by requiring them to receive the permission of the Deputy Attor-

<sup>105</sup> See Gibson Dunn, *2008 Year-End Update supra* note 14 (“[...] absent consistent and uniform guidance, a corporation has no way of measuring the consequences of coming forward and self-reporting potential criminal activity.”) For suggested guidelines, see Warin and Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, 121-134; Spivack and Raman, *Regulating the ‘New Regulators’: Current Trends in Deferred Prosecution Agreements*, 159-194.

<sup>106</sup> See e.g., Brandon L. Garrett, *Structural Reform Prosecution*, VA. L. REV. 93 (2007), 853-957; Erik Paulsen, *Imposing Limits on Prosecutorial Discretion in Corporate Prosecution Agreements*, N.Y.U. L. REV. (1950) 82 (2007), 1434; Warin and Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, 121-134; John C. Jr Coffee, *Deferred Prosecution: Has it Gone Too Far?* THE NAT. L.J. (July 25, 2005), 13.

<sup>107</sup> See Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1885: (“[t]he offender can choose either to agree to the terms of deferral as defined by the prosecutor, or to reject the deferral and face the adverse publicity of a trial and the potential collateral consequences of a felony conviction. The corporation offender’s unique vulnerability to adverse publicity and collateral consequences sets the stage for a deferral negotiation that ‘stack[s] the deck against the defendant’ and calls into question whether the choice to enter into deferral is really a choice at all.”) [References omitted – S.O.]. See also Weissmann and Newman, *Rethinking Criminal Corporate Liability*, p. 414 (“In the post-Enron world, it is the rare corporation that will risk indictment by the Department of Justice (DOJ), let alone a trial. The financial risks are simply too great. Knowing this, the government has virtually unfettered discretion to exact a deferred prosecution agreement from a corporation that mandates fines and internal reforms.”)

<sup>108</sup> See Gibson Dunn, *2009 Mid-Year Update, supra* note 15 (“in the past, the DOJ often declined to prosecute cases in which the allegations involved low-level misconduct or there was a lack of sufficient evidence. However, the increased use of DPAs and NPAs raises a question of whether this new prosecutorial tool may be encouraging the government to seek agreements with corporations in instances that previously resulted in declinations.”) See also, Weissmann and Newman, *Rethinking Criminal Corporate Liability*, p. 414 (“Contrary to the system of checks and balances that pervades our legal system, including the criminal law with respect to individuals, no systemic checks effectively restrict the government’s power to go after blameless corporations.”)

<sup>109</sup> See Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1895. See also Gibson Dunn, *2009 Year-End Update, supra* note 12, reporting that most recent DPAs/NPAs include a provision that grants the DOJ “sole discretion to determine whether the agreement has been breached by the company.”

<sup>110</sup> See Jennifer Arlen, “Removing Prosecutors from the Boardroom: Limiting Prosecutorial Discretion to Impose Structural Reforms,” in *Prosecutors in the Board Room: Using Criminal Law to Regulate Corporate Conduct*, Anthony S. Barkow and Rachel E. Barkow eds. (New-York: New York University Press, 2011), 62-86.

<sup>111</sup> See *Id.*

ney General before entering into any DPA.<sup>112</sup> An alternative proposal encourages greater involvement of the judicial system in interpreting and applying the terms of DPAs.<sup>113</sup>

On top of that, scholars addressed the risk that corporate monitors' powers expand beyond the original authority DPAs intended to grant.<sup>114</sup> One proposal suggests limiting the use of corporate monitors only to very rare cases.<sup>115</sup> A different proposal recommends that prosecutors and corporations should better specify corporate monitors' tasks and powers in the DPA, leaving little discretion for the monitors to determine their own powers.<sup>116</sup> A related criticism focuses on the position of corporate monitors as surrogate policeman, acting on behalf of the government.<sup>117</sup> As "outsiders," corporate monitors may face substantial difficulties in accessing all kinds of internal, informal relevant information.<sup>118</sup>

Lastly, scholars criticized the selection process of corporate monitors.<sup>119</sup> In the absence of specific guidelines, corporate monitors were not subject to qualifications or expertise requirements, and their appointment was widely influenced by the personal discretion of the individual prosecutors in charge.<sup>120</sup> Interestingly, such monitors were usually selected from a small group of former public officials, rather than through any market mechanism.<sup>121</sup> This susceptible aspect of corporate monitors drew the media's attention and rendered intensive criticism in 2007, when the New Jersey U.S. Attorney Chris Christie awarded a \$52 million contract to a consulting firm—founded by the former Attorney General John Ashcroft—to serve as a corporate monitor.<sup>122</sup> To prevent the tangible risk of abuse of prosecutorial powers, scholars have strongly recommended that the government appoint corporate monitors through a transparent process, verifying their background and expertise, and appointing them based on merit.<sup>123</sup> In the same vein, scholars have suggested that corporate monitors, who are not selected by shareholders and are not subject to market forces that could discipline their behavior, should be subject to fiduciary duties to shareholders and thus, be held accountable to them.<sup>124</sup>

<sup>112</sup> See Paulsen, *Imposing Limits on Prosecutorial Discretion in Corporate Prosecution Agreements*, 1434.

<sup>113</sup> See Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, p. 1904. The author suggests reducing the risk of an abuse of prosecutorial discretion by increasing the judicial involvement "not during the negotiation phase of the [agreement], but rather during the implementation of the [agreement], where dissolution of the agreement can result in prosecution and the stakes are highest." See also Warin and Boutros, *Deferred Prosecution Agreements: A View from the Trenches and a Proposal for Reform*, p. 128 ("The DOJ should surrender to the courts at the preindictment stage the determination of whether a corporation has materially breaches the terms of a DPA.")

<sup>114</sup> See e.g., O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, 89-118.

<sup>115</sup> See *Id.*

<sup>116</sup> See Khanna and Dickinson, *supra* note 14, at 1737.

<sup>117</sup> See Sue Reisinger, *Designated Drivers*, CORP. COUNS. (October 2004).

<sup>118</sup> See Sung H. Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 448, 460 (2008).

<sup>119</sup> See e.g., Khanna and Dickinson, *supra* note 14, at 1719.

<sup>120</sup> See *Id.*

<sup>121</sup> See *supra* notes 84-70 and the related text.

<sup>122</sup> See e.g., Neil Gordon, *Checking Up on DPAs, NPAs and Corporate Monitors*, Exposing corruption, exploring solutions: Project on government oversight (June 26, 2009); Eric Lichtblau and Kitty Bennett, "30 Former Officials Became Corporate Monitors," *N.Y. Times*, May 23, 2008, .; Christopher M. Matthews, "Compliance Monitors are here to Stay," *Main Justice: Politics, Policy and the Law* (April 8, 2010, 2010)

<sup>123</sup> See Khanna, *supra* note 51, at 226-248.

<sup>124</sup> See O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, p. 105, who explains that the corporate monitors' primary responsibility is not to benefit shareholders, but rather to further the court order; See also, Khanna and Dickinson, *supra* note 14, at 1742, who suggest to establish a fiduciary duty to corporate monitors.

#### IV. EMERGING DPAS POLICIES

It seems that the growing criticism of DPAs and of the lack of adequate policies concerning corporate monitors, has caused the use of DPAs to decline in 2008/2009 (See Figure 1 above).<sup>125</sup> Yet, the cumulative experience gained with respect to DPAs, coupled with the growing criticism of the mechanism, led U.S. policymakers to take initial steps to regulate the use of DPAs. The first attempts were undertaken in 2008 and 2009, through several Bills presented before the U.S. Congress.<sup>126</sup> These bills were aimed at requiring the DOJ to promulgate official guidelines with respect to the appointment and function of corporate monitors. The bills acknowledge the use of DPAs and corporate monitors, while addressing the criticism raised through several recommendations for amendments to the prevalent policy.<sup>127</sup>

#### **Recommendation for Reforms included in the Bills Presented before the U.S. Congress**

- ***Clear guidelines*** – The bills require the Attorney General to issue public written guidelines for DPAs.<sup>128</sup> Such guidelines should cover, *inter alia*, the criteria under which it would be appropriate for federal prosecutors to enter into DPAs, the appropriate terms and conditions of DPAs, the circumstances in which corporate monitors are warranted, and the duties and powers of such monitors.<sup>129</sup>
- ***A Core of Corporate Monitors*** – The bills require the Attorney General to create a publicly available “national list of possible corporate monitors.”<sup>130</sup> Such a list shall include “*organizations and individuals who have the expertise and specialized skills necessary to serve as independent monitors.*”<sup>131</sup>
- ***Selection process and compensation of Corporate Monitors*** - The bills require

<sup>125</sup> Gibson Dunn, *2008 Year-End Update*, *supra* note 14, suggests that the ‘downturn’ in the use of DPAs and NPAs may “reflect the debate surrounding DPAs and cautious approach that the DOJ took in entering into DPAs while awaiting further legislative and guidance.” See also Corporate Crime Reporter, *Crime without Conviction: The Rise of Deferred and Non Prosecution Agreements*.

<sup>126</sup> See *Accountability in Deferred Prosecution Act of 2008*, H.R. 6492, 110th Cong. (2d Sess. 2008), available at: <http://www.govtrack.us/congress/billtext.xpd?bill=h110-6492>; *To require the Attorney General to issue guidelines delineating when to enter into deferred prosecution agreements, to require judicial sanction of deferred prosecution agreements, and to provide for Federal monitors to oversee deferred prosecution agreements*, H.R. 5086, 110th Cong. (2d Sess. 2008), available at: [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:h5086ih.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h5086ih.txt.pdf); and *Accountability in Deferred Prosecution Act of 2009*, H.R. 1947, 111th Cong. (1st Sess. 2009), available at: [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h1947ih.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1947ih.txt.pdf) (Hereinafter H.R. 1947). This Bill was referred to the House subcommittee Commercial and Administrative Law on May 26, 2009 (See [http://www.washingtonwatch.com/bills/show/111\\_HR\\_1947.html](http://www.washingtonwatch.com/bills/show/111_HR_1947.html)).

<sup>127</sup> All following references to the content of the Bills are brought with respect to the most recent Bill, H.R. 1947, *supra* note 126 This bill defines DPA as “an agreement between a Federal prosecutor and an organization to conditionally defer prosecution of that organization in a criminal case in which charges are filed;” an NPA is defined as “an agreement between a Federal prosecutor and an organization to conditionally decide not to file criminal charges against the organization;” and an ‘independent monitor’ is defined as “a person or entity outside the Department of Justice that is selected to oversee the implementation of a deferred prosecution agreement or nonprosecution agreement.”

<sup>128</sup> See Sec 4 of the Bill H.R. 1947, *supra* note 127.

<sup>129</sup> See *Id.*

<sup>130</sup> See Sec 5(b) of the Bill H.R. 1947, *supra* note 127

<sup>131</sup> See *Id.*

the Attorney General to establish rules for the selection of corporate monitors for DPAs that will ensure the credibility of the selection process, while allowing for an “*open, public, and competitive process for the selection of such monitors.*”<sup>132</sup> In addition, the Attorney general is required to establish a publicly available fee schedule for the compensation of independent monitors.<sup>133</sup> Furthermore, the bills seek to ensure the credibility of the corporate monitor selection process by limiting the participation of attorneys involved in the prosecution.<sup>134</sup>

- **Judicial Oversight of DPAs** – The bills propose a court oversight mechanism for DPAs.<sup>135</sup> DPAs must get court approval before entering into force, and the parties to the agreement as well as the corporate monitors are required to submit to the court quarterly reports on the progress made toward the completion of the DPA, to allow the court to ensure that the implementation or termination of the DPA is consistent with the interests of justice.<sup>136</sup>

Due to the growing interest in DPAs and the practical need for official guidelines, while the bills are pending with the U.S. Congress, the DOJ has promulgated its first official guidance regarding the selection and use of corporate monitors in DPAs on March 7, 2008, in a memorandum by Craig S. Morford, Deputy Attorney General (“*Morford Memo*”).<sup>137</sup> The Morford Memo covers the following substantial issues regarding the use of corporate monitors in DPAs:

- **When Corporate Monitors Should be Used** – The Morford Memo strives to ensure an efficient use of corporate monitors in DPAs. Therefore, it explicitly states that monitors should be used only when appropriate given the specific circumstances at hand.<sup>138</sup> The Memo sets forth a “cost-benefit” criterion for the use of corporate monitors; that is, before requiring the appointment of a corporate monitor, the prosecutor is required to consider the “potential benefits that employing a monitor may have for the corporation and the public’ against ‘the cost of a monitor and its impact on the operations of a corporation.”<sup>139</sup> The Memo provides specific examples for such circumstances: (a) where a company does not have an effective internal compliance program, or (b) when the company needs to establish necessary internal controls.<sup>140</sup>
- **Criteria for Selecting a Monitor** – To ensure that appointed corporate monitors possess the required expertise and qualifications, the Morford Memo sets forth the *criteria* for the appointment of corporate monitors. The criteria requires the monitor, first and foremost, to be “a *highly qualified and respected person or entity based on suitability for the assignment and all of the circumstances.*”<sup>141</sup> In addition, the corporate monitor must be independent, such that the appointment

<sup>132</sup> See Sec 5(c) of the Bill H.R. 1947, *supra* note 127.

<sup>133</sup> See Sec 5(d) of the Bill H.R. 1947, *supra* note 127.

<sup>134</sup> See Sec 6(b) of the Bill H.R. 1947, *supra* note 127.

<sup>135</sup> See Sec 7 of the Bill H.R. 1947, *supra* note 127.

<sup>136</sup> See *Id.*

<sup>137</sup> See Morford, Craig S., Acting Deputy Attorney General, *Memorandum for Heads of Department Components United States Attorneys: Selection and use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations*, Mar. 7, 2008.

<sup>138</sup> See *Id.* § I.

<sup>139</sup> See *Id.*

<sup>140</sup> See *Id.*

<sup>141</sup> See *Id.* § II(1).

avoids any “potential or actual conflicts of interest.”<sup>142</sup> Furthermore, the Morford Memo creates a detailed procedure for the *selection of monitors*. The procedure starts with a discussion between the corporation and the government, which is aimed at identifying the qualifications for a monitor in the particular case.<sup>143</sup> Then, the procedure requires the creation of a specialized committee that will consider all corporate monitor candidates.<sup>144</sup> Finally, the Office of the Deputy Attorney General must approve the appointment.<sup>145</sup>

- ***Role and Responsibility*** – The Morford Memo clarifies that the role of corporate monitors serves no punitive goals, but rather it boils down to assessing and monitoring corporate compliance with the terms of the agreement, while reducing the risk for misconduct.<sup>146</sup> To prevent the risk of overreaching powers, the Morford Memo also clarifies that “the monitor’s responsibility should be no broader than necessary to address and reduce the risk of recurrence of the corporation’s misconduct.”<sup>147</sup> In the same vein, it is made clear that the corporate monitor is not responsible for the corporation’s shareholders, and therefore, corporations remain responsible for the design of ethics and compliance programs, subject to the monitor’s input, evaluation and recommendations.<sup>148</sup> On top of that, according to the Morford Memo, corporate monitors may be required to provide the government and the corporation with periodic written reports regarding their activities, as well as recommendations for changes required to foster corporate compliance with the agreement.<sup>149</sup> If the corporation chooses not to adopt those recommendations, a report must be submitted to the government along with the corporation’s reasoning.<sup>150</sup>

The Morford Memo, which for the first time laid out the basic rules for the use of corporate monitors, substantially contributed to the selection process of corporate monitors in subsequent DPAs.<sup>151</sup> For instance, the DPAs reached in the Willbros Group’s and AGA Medical’s cases explicitly required the corporate monitors to possess “demonstrated expertise with respect to the FCPA, including experience counseling on FCPA issues;” and “experience [in] designing and/or reviewing corporate compliance policies, procedures and internal controls, including FCPA-specific policies, procedures and internal controls.”<sup>152</sup> Nevertheless, the Morford Memo did not go so far as to create a publicly

<sup>142</sup> See *Id.* § II. According to the Morford Memo, the corporation must commit itself ‘not to employ or be affiliated with the monitor’ during the period of the agreement and an additional one year after its termination. See also Sec III, according to which monitors must be independent third-parties, not employees or agent of the corporations or of the government.

<sup>143</sup> See *Id.* § II.

<sup>144</sup> See *Id.* § II.

<sup>145</sup> See *Id.* § II.

<sup>146</sup> See *Id.* §§. I and III.B.3.

<sup>147</sup> See *Id.* §§ 1 and III.B.4.

<sup>148</sup> See *Id.* § III.B.3.

<sup>149</sup> See *Id.* §§ III.C.5-6.

<sup>150</sup> See *Id.*

<sup>151</sup> See Gibson Dunn, 2008 Year-End Update, *supra* note 11.

<sup>152</sup> See Deferred Prosecution Agreement of *Willbros Group Inc.*, May 14, 2008, §12. Available at: <http://www.techagreements.com/agreement-preview.aspx?num=585046&title=willbros%20group%20->

available “core of corporate monitors” as proposed in the bills discussed above. Hence, the appointment of corporate monitors remained, thus far, a matter of particular negotiation between the government and the relevant corporation—a process that is still being criticized and may require future reevaluations.

On May 14, 2008, the Deputy Attorney General, Mark Filip, issued a new Memorandum dealing with Federal Prosecution of Business Organizations (“*Filip Memo*”).<sup>153</sup> The Filip Memo reinforces the factors previously determined in the Holder and Thompson Memos with some minor adjustments,<sup>154</sup> and supports the use of DPAs as a valuable prosecutorial means of controlling corporate behavior:

In certain instances, it may be appropriate, upon consideration of the factors set forth herein, to resolve a corporate criminal case by means other than indictment. *Non-prosecution and deferred prosecution agreements, for example, occupy an important middle ground between declining prosecution and obtaining the conviction of a corporation.*<sup>155</sup>

The development of DPAs continued in 2010 by the promulgation of a new Memorandum by Deputy Attorney General, Gary G. Grindler, released on May 25, 2010 (“*Grindler Memo*”).<sup>156</sup> This Memo supplements the Morford Memo with an additional principle that guides prosecutors to explicitly explain in future DPAs “what role the Department [of Justice] could play in resolving any disputes between the monitor and the corporation, given the facts and circumstances of the case.”<sup>157</sup> The Grindler Memo requires prosecutors to consider incorporating the following provision in future DPAs:

With respect to any Monitor recommendation that the company considers unduly burdensome, impractical, unduly expensive, or otherwise inadvisable, the company need not adopt the recommendation immediately; instead, the company may propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which the company and the Monitor ultimately do not agree, the views of the com-

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*%20deferred%20prosecution%20agreement*; See also DOJ Press Release No. 08-417, *Willbros Group Inc. Enters Deferred Prosecution Agreement and Agrees to Pay \$22 Million Penalty for FCPA Violations*, (May 14, 2008). Available at: <http://www.foley.com/files/WillbrosDOJRelease.pdf>. Compare with *Deferred Prosecution Agreement of AGA Medical*, June 3, 2008, §10. Available at: <http://www.law.virginia.edu/pdf/faculty/garrett/agamedical.pdf>; and DOJ Press Release No. 08-491, *AGA Medical Corporation Agrees to Pay \$2 Million Penalty and Enter Deferred Prosecution Agreement for FCPA Violations* (June 3, 2008). Available at: <http://www.justice.gov/opa/pr/2008/June/08-crm-491.html>. See also Blank Rome LLP, *Keeping A Watchful Eye: Corporate Deferred Prosecution Agreements and the Selection of Corporate Monitors*.

<sup>153</sup> See Filip, Mark R., Memorandum for Heads of Department Components United States Attorneys, Department of Justice, Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008). The Filip Memo was incorporated into the U.S. Attorney’s Manual, *supra* note 20, available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/28mcrm.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm).

<sup>154</sup> See *Id.* § 9-28.300.

<sup>155</sup> See *Id.* § 9-28.200.B. See also Mark J. Stein & Joshua A. Levine, *The Filip Memorandum: Does It Go Far Enough?*, N.Y.L.J. (Sept. 10, 2008).

<sup>156</sup> See Grindler, Gary G., Memorandum for Heads of Department Components United States Attorneys, Department of Justice, *Additional Guidance on the Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations* (May 25, 2010), available at <http://www.justice.gov/dag/dag-memo-guidance-monitors.html>.

<sup>157</sup> See *Id.*

pany and the Monitor shall promptly be brought to the attention of the Department. The Department may consider the Monitor's recommendation and the company's reasons for not adopting the recommendation in determining whether the company has fully complied with its obligations under the Agreement.<sup>158</sup>

Furthermore, the Grindler Memo requires prosecutors to consider incorporating another provision that requires corporations and DOJ representatives to meet together at least annually to discuss "the monitorship and any suggestion, comments, or improvements the company may wish to discuss with or propose to the [DOJ], including with respect to the scope or costs of the monitorship."<sup>159</sup>

Although the DOJ policy concerning DPAs has substantially progressed along the last few years, not all potential concerns have been fully addressed by policymakers. For instance, despite the guidance provided by the DOJ in recent years, the actual content of DPAs is still subject to considerable prosecutorial discretion. Most recent DPAs entered into by the DOJ demonstrate some initial standardization in their components.<sup>160</sup> Yet, details such as the severity of fines imposed, and the length of the agreement seem to be decided on a case-by-case basis. In that respect, a publicly available list of factors determining the content of DPAs may increase transparency and consistency of DPAs.<sup>161</sup> Furthermore, the guidance provided in the DOJ memoranda regarding the selection and appointment of corporate monitors seems to considerably improve the heavily criticized procedures previously followed by prosecutors. Yet, the cost-benefit criterion established by the Morford Memo for the use of corporate monitors may be too vague. A list of factors that should be considered when deciding whether to request the appointment of corporate monitor may promote the transparency and consistency of the use of DPAs. Along the same line, future development of prosecutorial policies may embrace the idea of creating a core group of corporate monitors that consists of professional individuals and organizations that have been screened and selected *ex ante*, according to their skills and expertise to serve as independent monitors. The creation of such a pool of corporate monitors will not only improve the transparency of the selection process of corporate monitors, but will also subject the monitors to some market forces that may enhance their trustworthiness and credibility.<sup>162</sup> On top of that, it seems that the criteria for the choice

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<sup>158</sup> See *Id.* § II.

<sup>159</sup> See *Id.*

<sup>160</sup> See Gibson Dunn, *2009 Mid-End Update*, *supra* note 9.

<sup>161</sup> Such a scheme was created by the OSG with respect to sentencing of convicted corporations. A similar scheme that regulates the determination of sanctions and length of DPAs may promote transparency and consistency in the use of this policy instrument.

<sup>162</sup> The idea of creating a market for corporate monitors has been promoted in Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991). See also Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 70 (1986), who shows that "[w]henver entry into a gatekeeping market requires significant capital, including investment in specific human capital or reputation, simple legal penalties such as civil damages, fines, or license revocations can be powerful deterrents." Similarly, EUGENE BARDACH & ROBERT A. KAGAN, *GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS*, 61-62 (1982) (emphasis added), argues: "Large corporations now have staffs of professionals concerned with regulatory matters – academically trained industrial hygienists, environmental engineers,

between DPAs and NPAs is insufficiently determined in current policies. As examined above, the lack of determined criteria has led to inconsistent use of both a DPA and an NPA, based on the same facts.<sup>163</sup> The establishment of clear criteria that guides the choice between the different types of agreements may, therefore, add some clarity to that issue.

## V. CONCLUSIONS

This paper discusses the emerging enforcement instrument, DPAs, which hinge upon prosecutors' agreement to defer criminal charges against culpable corporations in exchange for corporations' commitment to adhere to some codes of conduct that are aimed at preventing reoccurrences of corporate crime. Unlike traditional criminal proceedings, DPAs may reach a unique prosecutorial balance between deterrence objectives and the unique challenges arising in times of economic meltdown. DPAs promote deterrence goals through a forward-looking cooperation between enforcement authorities and corporations that have broken the law. As such, this mechanism may save enormous enforcement costs and minimize undesirable collateral effects—virtues that make this instrument particularly invaluable in times of economic meltdown.

Many of the substantial concerns advanced in the scholarly literature regarding DPAs and the use of corporate monitors in DPAs were addressed in a series of memoranda promulgated by the DOJ from 2008-2010. Some concerns still need to be addressed in the future. Nevertheless, the recent developments in U.S. enforcement policy concerning DPAs have paved the way for a better deployment of DPAs as a key prosecutorial instrument. In actuality, these recent development are correlated with a significant increase in the number of DPAs entered into in 2010 and in the first half of 2011.<sup>164</sup> Only the future will tell whether this is a beginning of a new trend that utilizes this valuable instrument to promote deterrence and meet economic recovery goals, or whether society lets a valuable tool collect dust.

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*toxicologists, safety experts, biologists, lawyers, occupational physicians, and specialists in administering affirmative action programs. These specialists are by no means uninterested in their corporation's balance sheet, but they also have some loyalty to the standards of their profession. 'I'm a licensed engineer, I'm not going to risk my license by lying to an agency,' a corporate environmental engineering told us."*

<sup>163</sup> See *supra* note 104 and the related main text.

<sup>164</sup> The number of DPAs increased from 19 and 21 agreements in 2008 and 2009 correspondingly, to 32 agreements in 2010 and 17 agreements in the first half of 2011. See Figure 1, and *Supra* note 54.

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