THE SHADOW
REGULATORY STATE
The Rise of Deferred
Prosecution Agreements

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The Shadow Regulatory State
Over the last decade, a novel form of federal government regulation has emerged, prompted not by new congressional legislation or administrative agency action but rather by aggressive assertion of prosecutorial authority over business. Without any actual criminal trials and little to no judicial supervision, government attorneys in the U.S. Department of Justice have pressured corporations to pay significant fines, to modify business practices, and even to sack top management.

The Justice Department and various U.S. Attorneys’ offices have entered into more than 200 “deferred prosecution” or “non-prosecution” agreements (DPAs and NPAs) in the last ten years. Seven of the 100 largest U.S. businesses, as ranked by Fortune magazine, are currently operating under the supervision of federal prosecutors.

The widespread use of DPAs and NPAs followed shortly in the wake of the federal government’s May 6, 2002, indictment of the large accounting firm Arthur Andersen. The U.S. Supreme Court ultimately set aside Andersen’s conviction in 2005, but the firm had long since collapsed—throwing tens of thousands of Americans out of work.

Many businesses can ill afford to fight a criminal investigation: criminal inquiries place significant pressure on stock prices and can impair companies’ ability to obtain credit, and businesses in some industries can be debarred from government contracting or denied government licenses upon an indictment or conviction. Precisely because companies cannot afford to face trial and because DPAs and NPAs enable prosecutors to punish perceived corporate wrongdoing without going to trial or facing the specter of an Andersen-like collapse, these tools have become increasingly commonplace.

In the process, the Justice Department has emerged as a shadow business regulator. Since 2005, federal prosecutors have entered into 20 or more such agreements annually, with a peak of 41 in 2007 and 40 in 2010. Financial and health-care companies are particularly sensitive to government licensing and contracting. Finance companies have been involved in 18 federal DPAs and NPAs since 2009, and health-care companies have entered into 11 such agreements over that period. The finance companies alone have a collective market capitalization exceeding $690 billion, with over $20 trillion in assets under management.

Fines and penalties levied under federal DPAs and NPAs have exceeded $3 billion in each of the last three years. Moreover, in reaching and enforcing these agreements, prosecutors have had sometimes sweeping impacts on business practices, variously pressuring companies:

- To change long-standing sales and compensation practices;
- To restrict or modify consulting, contracting, and merger decisions;
- To implement onerous compliance and reporting programs;
- To appoint corporate monitors who report to prosecutors, with broad discretion over business decisions; and
- To oust executives or directors.

Once under a DPA or an NPA, company leadership has little ability to object to prosecutorial demands: the agreements typically state that determinations as to whether a company is in breach are the prosecutor’s alone and are beyond judicial review. To explicate further how these agreements work in practice, this report explores the details of recent DPAs and NPAs reached between federal prosecutors and four companies: MetLife, Johnson & Johnson, Wright Medical Technology, and Tenaris S.A.
The process whereby federal prosecutors enter into DPAs and NPAs lacks transparency and judicial oversight, and the broad sweep of these arrangements imposes a little-appreciated regulatory burden with real economic impact. To improve transparency and oversight, to maintain appropriate incentives for companies to comply with the law, and to rein in the shadow regulation of business by federal prosecutors, Congress should:

- Restrict the application of criminal law against corporations to serious predicate offenses by major officials;
- Reexamine the severity of statutory consequences flowing from a criminal indictment, such as debarment;
- Limit the use of DPAs that preclude a judicial role in reviewing agreement terms, selecting corporate monitors, or determining whether management has breached the agreement;
- Insist that DPAs and NPAs carefully consider preexisting corporate compliance programs as a mitigating factor to encourage better business self-policing; and
- Narrow the scope of agreement terms available under DPAs and NPAs to limit potential economic disruption.

**About the Author**

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Copland has published opinion columns in national, local, and online newspapers, including *The Wall Street Journal*, *The National Law Journal*, *Investor’s Business Daily*, and *USA Today*. He has appeared on various television and radio shows, including ones on PBS, FOX News, FOX Business, MSNBC, CNBC, C-SPAN, and NPR. He has testified before Congress and is a conference participant as well as a regular speaker on tort reform issues.

Prior to joining the Manhattan Institute, Copland was a management consultant with McKinsey and Company in New York. He earlier served as a law clerk for Ralph K. Winter on the United States Court of Appeals for the Second Circuit. He has been a director of two privately held manufacturing companies since 1997.

Copland received J.D. and M.B.A degrees from Yale, where he was an Olin Fellow in Law and Economics and an editor of the *Yale Journal on Regulation*. He also has an M.Sc. in the politics of the world economy from the London School of Economics and a B.A. in economics with highest distinction and highest honors from the University of North Carolina at Chapel Hill, where he was a Morehead Scholar.
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In the last two years, Congress has passed two major laws—the Patient Protection and Affordable Care Act; and the Dodd-Frank Wall Street Reform and Consumer Protection Act—intended to reform the regulatory structure governing two major sectors of the American economy: health care and finance, respectively. But with far less fanfare, executive-branch attorneys have also been effecting major changes in these industrial sectors and others, based on proliferating, vague federal criminal laws but otherwise with little congressional guidance and oversight. Under the threat of prosecution but no actual criminal trials, some of the nation’s largest corporations have been pressured to pay significant fines and have removed top executives and significantly modified business practices at the insistence of officials from the Department of Justice (DOJ).

These developments have arisen under the auspices of arrangements known by bland, even benign-sounding, names such as “deferred prosecution” or “non-prosecution” agreements (DPAs and NPAs). Such arrangements are relatively novel in American legal practice, dating back only to 1993, but are increasingly common: though federal prosecutors and companies entered into only 17 DPAs and NPAs during the first decade of the practice, there have been 207 such agreements since 2004. While these agreements have been concentrated in the financial and health-care sectors, they span the economy. Indeed, seven of the 100 largest U.S. businesses, as ranked by Fortune magazine, are currently operating under the supervision of federal prosecutors: CVS Caremark, Google, Johnson & Johnson, JPMorgan Chase, Merck, MetLife Insurance, and Tyson Foods. Many
others have entered into such agreements in recent years, including American Express, Boeing, Bristol-Myers Squibb, Chevron, Monsanto, Pfizer, and Sears.

The fines and penalties levied under these arrangements have been sizable, in total over $7.7 billion just since the beginning of 2010. At least as serious as the fines imposed is the degree to which corporate leaders have had to modify business practices to please DOJ lawyers. Under DPAs and NPAs, federal prosecutors can go so far as to require companies to implement onerous training and reporting programs, hire senior officials to oversee companies’ “compliance” with prosecutors’ legal interpretations, modify sales-force practices and compensation plans, contract with independent “monitors” empowered to dictate modifications to business practices, and even fire and replace directors or chief executives. Moreover, companies under a DPA or an NPA have little choice but to submit to a prosecutor’s directives, however whimsical; such agreements typically state that determinations as to whether a company is in breach are the prosecutor’s alone and are beyond judicial review.

In critiquing “regulation by prosecution” through the use of federal DPAs and NPAs, this paper is not arguing against regulation per se. Corporations should be subject to regulation, and the criminal law rightly applies to some commercial activity—by individuals, if not corporate entities themselves. Reasonable minds may differ on whether and where U.S. law underregulates, as well as overregulates, certain corporate actions; the question is whether DPAs and NPAs are a preferred mechanism for achieving regulatory goals.

To answer that question, this report explores the growth of federal deferred-prosecution and non-prosecution agreements and their implications. Part I briefly summarizes the history of the practice and explores the respective rationales of government officials and corporate leaders for reaching such agreements. Part II looks at DPA and NPA trends quantitatively and includes a presentation of year-by-year trends in the number of such agreements and the level of fines imposed. Part III takes a qualitative look at DPAs and NPAs, discussing the arrangements with four companies—MetLife, Johnson & Johnson, Wright Medical Technology, and Tenaris—to show how typical features of such agreements work in practice. Part IV discusses public policy reasons for concern, based on previous commentary and additional analysis. Part V concludes with recommendations for reform.

I. HISTORY: THE EMERGENCE OF DPAS AND NPAS

As presented in more detail in “Regulation by Prosecution: The Problems with Treating Corporations as Criminals,” the practice of criminally prosecuting businesses as distinct entities is deeply rooted in Anglo-American law, as it is not in continental Europe, and goes as far back as the England of 1635. But such actions historically tended to focus on so-called public nuisances and were designed to spur municipal corporations, the equivalent of modern local governments, to pursue amelioration of the offending conditions; the general rule, as noted by eighteenth-century English legal scholar William Blackstone in his influential Commentaries, was that a corporation “cannot commit … crime in its corporate capacity, though its members may in their distinct individual capacities.”

The rise of the federal regulatory state, from the late nineteenth century through the New Deal era of the 1930s, ushered in a new type of corporate criminal prosecution, for violations by private companies of the myriad of regulations promulgated to constrain their conduct. The modern practice of prosecuting corporations as entities for major crimes and deferring such prosecutions by agreement was jump-started in 1991, when the U.S. Sentencing Commission, which was charged with writing “guidelines” to ensure consistency in sentencing for federal crimes, recommended the awarding of “credit” to entities for “cooperating” in criminal investigations. This push for cooperation between companies and prosecutors was grounded in the hope that the prospect of a reward for cooperation would induce companies to ferret out criminal misconduct by their employees on their own, thereby discouraging its occurrence and shifting the burden of discovery and discipline from investigative agencies.
Businesses, in turn, have powerful reasons not to want a criminal investigation or prosecution to proceed to trial. Criminal inquiries place significant pressure on stock prices and can impair companies’ ability to obtain credit. The cost of a criminal conviction can be particularly devastating for companies that are heavily regulated by the government or that do business with it. For example, convicted financial firms can lose their broker-dealer license, their banking license, or their federal deposit insurance, and healthcare companies convicted of a crime can be barred from receiving payment from federal Medicare and Medicaid programs. (Not coincidentally, DPAs and NPAs are significantly concentrated among companies in the finance and health-care sectors, as discussed in Part III.)

For such reasons, in 1993 the investment bank Salomon Brothers reached the first non-prosecution agreement with the federal government. Over the decade following the Salomon NPA, the federal government entered into 17 NPAs and DPAs. (Although DPAs and NPAs are often used interchangeably—and the DOJ articulates no clear standard governing when one is more appropriate than the other—they are technically distinct. NPAs are reached before criminal charges are actually filed and thus involve no court oversight. DPAs, in contrast, follow the levying of criminal charges—which are then “deferred”—and thus at least formally require judicial approval.)

Though used rarely over the first ten years of their existence, the number of federal DPAs and NPAs rose dramatically in the middle part of the last decade. Two factors, in particular, precipitated the increase in such arrangements. First, the 2002 collapse of the venerated Arthur Andersen accounting firm in the wake of its federal indictment for a single count of obstruction of justice—the wisdom of which was further challenged by its subsequent conviction’s reversal by the U.S. Supreme Court—highlighted for corporate criminal defendants as well as the DOJ the risks of prosecuting businesses as entities. (Andersen was reportedly offered a DPA but objected to the accompanying conditions.) The question of fairness aside, the firm’s collapse cost thousands of employees their jobs, and reduced large companies’ choice of auditor to the remaining Big Four accounting firms.

On the heels of the Andersen case, Deputy U.S. Attorney General Larry Thompson issued in 2003 a memorandum outlining the factors that the DOJ should consider in deciding whether to prosecute corporations. Thompson’s memorandum built upon an earlier memo issued in 1999 by Thompson’s predecessor, Eric Holder, which sketched out rules for crediting corporate cooperation in prosecutions, including “the corporation’s … willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the corporate attorney-client and work product protection.” Although this attack on the attorney-client privilege proved controversial, Thompson’s memo, instead of retreating, made Holder’s rule proposals binding. It also, for the first time, expressly offered pretrial diversion or deferred prosecution as an option for cooperating corporations.

In 2004, the first full year following the issuance of the Thompson memo, the DOJ entered into only four DPAs, but federal prosecutors soon discovered their broad appeal to companies. In 2005, the number of federal DPAs and NPAs rose to 20—almost as many as were struck in the previous 12 years. The current wave of such agreements had begun.

II. QUANTITATIVE ANALYSIS: CURRENT TRENDS IN FEDERAL DPA AND NPA ACTIVITY

A review of publicly known federal DPAs and NPAs shows that the number of such agreements and the size of the fines levied under them have escalated dramatically in recent years. This section of the report outlines quantitative trends in federal DPA and NPA activity, including the types of crimes alleged, prosecuting divisions and companies involved, and agreement structure.
since 2005 the DOJ and U.S. Attorneys' Offices have entered into 20 or more such agreements annually, with a peak of 41 such agreements in 2007 and 40 agreements in 2010. Moreover, the dollar value of fines and penalties imposed under DPAs and NPAs has risen to much higher levels in recent years: such monetary assessments were $289 million in 2008, but they have exceeded $3 billion in each of the last three years (see Chart 2).

**DPA and NPA Trends: Crimes Alleged**

Since 2010, 38 percent of DPAs and NPAs have concerned alleged violations of the Foreign Corrupt Practices Act (FCPA), which prohibits companies from offering bribes, kickbacks, or other payments to foreign government officials. Some 36 percent have involved various alleged frauds, with a particular focus in recent years on frauds in the health-care sector. The rest of these agreements have been limited to a handful of other offenses, including a variety of alleged frauds or kickbacks, money laundering, antitrust offenses, Internet gambling, and import-export issues (see Chart 3).

**DPA and NPA Trends: Prosecuting Divisions Involved**

Most DPAs and NPAs have originated with a small number of divisions of the DOJ—notably, the Fraud Section of the Criminal Division. Only a minority of the
U.S. Attorney’s Offices have entered into a DPA or an NPA, but the Southern District of New York has entered into more than 20, with a small number of other offices also playing a large role—notably, the Eastern District of New York, the District of Massachusetts, the Central District of California, and the District of New Jersey.36 On January 13, 2010, in a groundbreaking shift, the Securities and Exchange Commission (SEC), under the leadership of enforcement director Robert Khuzami, a former federal prosecutor, announced its intention to use DPAs and NPAs as part of its new “Cooperation Initiative.”37 This step marked a departure from the SEC’s historical practice, which had generally been to enter into civil consent orders in federal district court, with corporations neither admitting nor denying wrongdoing;38 indeed, the SEC’s new role in crafting DPAs and NPAs is rather remarkable, given that the agency lacks independent criminal enforcement authority.39 On December 17, 2010, the SEC entered into its first NPA, with Carters, Inc., and on May 17, 2011, it entered into its first DPA, with Tenaris S.A., a Luxembourg-based company.

DPA and NPA Trends: Companies Involved

As noted earlier,40 a plurality of federal DPAs and NPAs has involved financial firms and health-care companies. Banks, insurance companies, and other financial businesses have been involved in 18 federal DPAs and NPAs since 2009, and health-care companies have entered into 11 such agreements.41 Many of these companies are among the largest domestically and worldwide; the finance companies alone—including ABN Amro Bank, Barclays Bank, Credit Suisse, Deutsche Bank, Fannie Mae, Freddie Mac, General Reinsurance, JPMorgan Chase, Lloyds TSB, Metropolitan Life Insurance, UBS, and Wells Fargo—have a collective market capitalization exceeding $690 billion, with over $20 trillion in assets under management.

Over the last two years, 45 percent of the DOJ’s agreements with companies have been NPAs, and the remaining 55 percent DPAs. Though the variety of such agreements makes a quantitative assessment of various terms and conditions difficult, it is worth noting that the DOJ seems to be de-emphasizing the appointment of “monitors” selected by prosecutors and paid by the company involved in the agreement, who serve to oversee the company’s behavior and recommend changes to business practice. Historically, 42 percent of FCPA agreements involved the appointment of a monitor, even after issuance of the Morford memorandum in 2008,42 which was intended to clarify the issue. Nine of the 40 federal NPAs and DPAs entered into in 2010 involved an appointed monitor, but only two of the 29 in 2011 did—one of which involved the U.S. Attorney’s Office for the District of New Jersey, which has appointed a monitor in each of the 11 NPAs and DPAs that it has drafted over time.

III. QUALITATIVE ANALYSIS: HOW DPAS AND NPAS WORK IN PRACTICE

An examination of publicly available DPAs and NPAs demonstrates the extent to which such arrangements tend to impinge upon and even dictate corporate decision making. In reaching and enforcing these agreements, prosecutors have variously bound corporations to change long-standing sales and compensation practices; to restrict or modify consulting, contracting, and merger decisions; to implement onerous compliance and reporting programs; and even to oust executives or directors. The reach of prosecutors through the DPA/NPA process is long indeed, extending even to foreign companies operating outside the United States. To explicate these issues further, this section of the report will briefly examine four recent federal DPAs and NPAs: MetLife, Johnson & Johnson, Wright Medical Technology, and Tenaris S.A.
Changing Corporate Practices I: The MetLife Insurance NPA

On April 15, 2010, under threat of indictment—possibly ruinous for an insurance company—MetLife entered into an NPA with the U.S. Attorney’s Office for the Southern District of California. The NPA involved alleged crimes revolving around the company’s practice, from 1999 through 2005, of making payments, including “contingent commissions,” to brokerages that sold the company’s insurance policies to various employers. (A contingent commission ties a nominally independent broker’s compensation to the total volume of business delivered to the underwriter, and thus arguably creates a conflict between the broker’s fiduciary obligation to secure the best price for his client and his own financial self-interest.) The NPA was, in essence, a follow-on agreement to that which had been reached between the company and New York attorney general Eliot Spitzer on December 29, 2006, for essentially the same conduct by MetLife, with federal jurisdiction premised on the Employee Retirement Security Act.

The terms of the MetLife NPA, which totals 15 pages with appendices, demonstrate the cost and impact that such agreements can have on corporations. On top of the restitution payments already made under the New York agreement, the company agreed to pay a fine of $13.5 million. Beyond the fine, the NPA stated that any determination as to whether it had breached the agreement rested “solely in the discretion” of the U.S. Attorney’s Office, “not subject to review in any court or tribunal outside the Department” and that the company would waive statute-of-limitations and other defenses should the U.S. Attorney seek to bring any future prosecution premised on a claimed breach. Among the two-year period of cooperation with the DOJ and four other federal agencies contemplated in the agreement were the submission of “all relevant information, documents, records or other tangible evidence” about which federal investigators inquired and “best efforts” to secure the attendance and cooperation of any officer or employee at any interview or proceeding requested by prosecutors. In addition to this general cooperation agreement, the company agreed not to pay any contingent brokerage commissions absent prior written notice of approval from policyholders, to implement various training programs for employees interacting with brokers, and to undertake various complementary auditing and compliance actions.

Changing Corporate Practices II: The Johnson & Johnson DPA

On April 8, 2011, the Fraud Section of the Criminal Division of the DOJ entered into a DPA with Johnson & Johnson, which, as a health-care company, could become ineligible for reimbursement under Medicare or Medicaid in the event of a criminal conviction. The DPA alleged that certain of the company’s corporate subsidiaries made direct and disguised payments to various employees of the government-run health-care systems of Greece, Poland, and Romania, which were deemed bribes and kickbacks paid to foreign officials, in violation of the FCPA. (While some of the allegations involved cash payments, some of the purportedly inappropriate expenses were more debatable, such as sponsoring Polish hospital employees’ conference attendance.) In addition, the DPA alleged that kickbacks had been paid to Saddam Hussein’s Iraqi government under the United Nations Oil-for-Food Programme.

The Johnson & Johnson DPA required the company to pay the U.S. Treasury a $21.4 million monetary fine, plus another $10 million or so in prejudgment interest, as well as to disgorge over $38 million in profits. In addition, the company agreed to a comprehensive three-year cooperation agreement similar to the one reached with MetLife.

Indeed, the compliance program to which J&J agreed was more sweeping than MetLife’s, as it included a requirement that the company submit to the DOJ six semiannual reports “setting forth a complete description of its remediation efforts to date [and] its proposals reasonably designed to improve the internal controls, policies, and procedures of J&J for ensuring compliance with the FCPA and other applicable anticorruption laws.” The company further agreed:

• to appoint a senior corporate executive, reporting
directly to the board of directors, to be chief compliance officer;\textsuperscript{54}

- to appoint heads of compliance for each business segment and a global leadership team for compliance;\textsuperscript{55}

- to implement periodic training for and annual certification by “all directors, officers, employees, and, where appropriate, agents and business partners”;\textsuperscript{56}

- to conduct periodic risk assessments of markets susceptible to corruption and conduct regular audits in operating companies in markets identified as risky, with audits to include on-site visits, the creation of action plans, and review of the books and records of distributors;\textsuperscript{57}

- to conduct due-diligence reviews of “sales intermediaries, including agents, consultants, representatives, distributors, and joint venture partners”;\textsuperscript{58}

- to write “[s]tandard provisions in agreements, contracts, and renewals thereof with all agents and business partners that are reasonably calculated to prevent violations of the anticorruption laws,” including “rights to conduct audits of the books and records of the agent or business partner to ensure compliance”;\textsuperscript{59} and

- to conduct due-diligence reviews of any acquisition targets and conduct a post-acquisition audit of any company acquired.\textsuperscript{60}

The Johnson & Johnson DPA, like the MetLife NPA, vested the DOJ with sole discretion to determine whether the company had breached the agreement, and the company waived any statutory defenses, should the department determine that a breach had occurred.\textsuperscript{61} Moreover, the J&J DPA includes a “public statements” provision, which is relatively common in such detailed agreements, that the company will not, “through present or future attorneys, directors, officers, employees, agents, or any other person authorized to speak for J&J make any public statement, in litigation or otherwise, contradicting the acceptance of responsibility by J&J set forth above or the facts described” in the agreement (with the exception of defenses available in civil or regulatory proceedings or those asserted as criminal defenses by individuals being prosecuted in an individual capacity).\textsuperscript{62}

\textit{Monitoring and Throwing Out Management: The Wright Medical Technology DPA}

On September 22, 2010, the U.S. Attorney’s Office for the District of New Jersey entered into a 12-month DPA with Wright Medical Technology, Inc.,\textsuperscript{63} an orthopedics-device manufacturer with a market capitalization of just over $600 million, concerning allegations that consulting fees that the company had paid to orthopedic surgeons from 2002 through 2007 were kickbacks intended to induce the doctors to use the company’s products.\textsuperscript{64} The company agreed to pay a $7.9 million fine,\textsuperscript{65} as well as to cooperate with federal investigators along the lines prescribed for MetLife and J&J.\textsuperscript{66} In addition, the agreement placed restrictions on the company’s hiring of consultants, including maximum hourly rates that it would be allowed to pay.\textsuperscript{67}

Like Johnson & Johnson, Wright Medical, as a health-care company, could little afford a criminal conviction that could bar it from receiving reimbursement through Medicare and Medicaid, so it agreed to a DPA with extensive monitoring and compliance requirements. At the insistence of the U.S. Attorney, the company implemented a compliance initiative; hired a compliance officer separate from the company’s general counsel; and expanded the duties of the Nominating, Compliance, and Governing Committee of its board of directors.\textsuperscript{68} The DPA also required the company to hire an outside monitor selected by the U.S. Attorney, and gave that monitor access to all non-privileged company documents, as well as “the authority to meet with any officer, employee, or agent” of the company.\textsuperscript{69} The monitor was charged with making a thorough review and evaluation of the company’s “policies, practices, and procedures,” making quarterly reports and recommendations to the U.S. Attorney, as well as reviewing and approving all new and renewed consulting agreements that the company was seeking to enter into.\textsuperscript{70} The monitor was further empowered to hire “consultants, accountants, or other professionals” at the company’s expense, subject to the ultimate approval of the U.S. Attorney; and the company was bound to follow the monitor’s recommendations—again, subject to review by the U.S. Attorney alone.\textsuperscript{71}
Predictably, the U.S. Attorney was vested with sole discretion to determine whether the agreement with Wright Medical had been breached. Moreover, the DPA required that the company report to the monitor and the U.S. Attorney any violation of any criminal law, whether or not material—an obligation that, in the assessment of the white-collar criminal-defense firm Gibson Dunn, not only “exacerbates the risk of a company running afoul of regulators” but also “places it at a substantial competitive disadvantage as it bears an obligatory reporting duty not shared by its competitors.”

The disclosure and breach provisions ripened on May 5, 2011, when the company publicly revealed the U.S. Attorney’s determination that it had materially breached the DPA. The company agreed to extend the DPA by a full year, notwithstanding a maximum six-month extension term in the original agreement. In the wake of the asserted breach, the company increased its compliance expenses, spending an estimated 4.2 percent of quarterly net revenues to implement the U.S. Attorney’s preferred compliance approach, and reported an adverse impact on company sales.

Perhaps the most striking impact of the Wright Medical DPA and its asserted breach is the resulting complete and total shakeup in corporate management. The board of directors fired the chief technology officer, and much of the rest of upper management resigned, including the chief executive officer, general counsel, chief compliance officer, vice president of clinical and regulatory affairs, and head of operations for Europe, the Middle East and Africa. Assistant U.S. Attorney Gilmore Childers noted approvingly: “As a direct result of the federal monitorship, Wright has made significant and wide-ranging changes in corporate culture and tone at the top. Our Office is pleased with the extensive cooperation from the newly appointed interim senior management team.” Little wonder that Gibson Dunn concluded that the U.S. Attorney’s Office had played “the role of kingmaker within the company, influencing the change in management and then underscoring the interim nature of the current management team.”

The two-year DPA that Tenaris reached with the SEC contains a cooperation agreement, an extensive compliance component, including extensive training and reporting requirements, the mandated hiring of an independent corporate compliance officer reporting to the board of directors, and a requirement that the company “institute appropriate due diligence and compliance requirements pertaining to the retention and oversight of all agents and business partners.” Among the agreements’ oversight mechanisms was a requirement that the company do business only with agents or business partners that permit the company “to conduct audits of the books and records of the agent or business partner to ensure compliance.”

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DOJ’s NPA and the SEC’s DPA with Tenaris each give the agency in question sole discretion to determine whether the company has acted in compliance with the agreement—creating the possibility that either the SEC or the DOJ might determine the company in breach, even if the other agency decides that it was broadly in compliance.

The Tenaris DPA and NPA highlight a salient feature of modern U.S. prosecutorial practice in this area: they affect many companies outside American borders. Tenaris is a foreign company with no U.S. subsidiary, accused of bribing foreign officials—and the only ties between its behavior and the United States asserted in the DPA and NPA are the listing of the company’s securities on the New York Stock Exchange and the routing of some $32,000 of its alleged kickbacks through U.S.-based Wachovia Bank.

In 2008, criticism reached a head when Congress held hearings on DPAs, and New Jersey congressman Frank Pallone introduced legislation, H.R. 5086, that would have required judicial oversight of DPAs, including findings of breach and selection of monitors, as well as requiring the DOJ to issue guidelines governing when DPAs may be entered into. Although Pallone’s bill never made it out of committee, in 2008 the DOJ reacted to criticism by issuing two clarifying memoranda and an addition to the United States Attorney’s Manual. In March 2008, Acting Deputy Attorney General Craig Morford issued a memorandum clarifying department policies on monitor selection and hiring, including conflict-of-interest rules, provisions for monitor independence, and rules requiring the approval of the Office of the Deputy Attorney General of any monitor hired. On May 14, 2008, in response to criticisms of previous DPAs that had ordered companies to make payments to charitable organizations unaffected by alleged misconduct, the DOJ added a provision to the U.S. Attorney’s Manual clarifying that “deferred prosecution agreements and non-prosecution agreements should not include terms requiring the defendant to pay funds to a charitable, educational, community, or other organization or individual that is not a victim of the criminal activity or is not providing services to redress the harm caused by the defendant’s criminal conduct.”

Finally, on August 28, 2008, Deputy Attorney General Mark Filip issued a memorandum stating that companies’ “liability for cooperation credit is not predicated upon the waiver of attorney-client privilege or work product protection.”

Despite these positive steps taken by the DOJ, some critics questioned their adequacy. Mark Stein and Joshua Levine, attorneys at Simpson Thacher & Bartlett, noted that the Filip memorandum did not stop prosecutors from leveraging threatened prosecution of the corporation to threaten individual employees’ protections in criminal investigations—including requiring that companies disclose facts harmful to employees’ criminal defense, notwithstanding joint employee-company defense agreements. The chairman of the Senate Judiciary Committee, Patrick Leahy, suggested that the Morford memo failed to do

IV. ASSESSMENT: REACTIONS AND REASONS FOR CONCERN

Early Critiques and Government Response

Once DPAs and NPAs emerged as major prosecutorial tools a few years ago, they prompted almost immediate criticism. Several observers cited concerns about the provisions in some agreements calling on companies to waive attorney-client and work-product privileges because of the implications for corporate employees’ individual civil liberties and because such rules might actually interfere with corporate compliance by discouraging employees from talking freely with corporate counsel. Others argued that the lack of judicial oversight in such agreements was a significant defect that required remediation. Still others criticized the process through which DOJ lawyers were appointing corporate monitors without clear oversight or rules governing conflicts of interest—and effectively serving as expensive and unchecked corporate overseers. Columbia law professor Jack Coffee worried that such agreements were overly invasive and—because some of the agreements mandated the replacement of directors or the formation of new board committees—were interfering with traditional shareholder rights and corporate governance.
anything about the reporting requirements of monitors and their compensation.103 (Companies surveyed by the U.S. Government Accountability Office [GAO] reported monitor fees typically in the millions of dollars, with a high of $38.7 million.104 In May 2010, Acting Deputy Attorney General Gary Grindler issued a follow-up memorandum clarifying the DOJ’s role in mediating disputes between corporations and appointed monitors,105 but it did not address Senator Leahy’s broader concerns.)

In a more far-reaching critique in response to a congressional inquiry, the GAO in 2009 reported that the DOJ “lacks performance measures to assess how DPAs and NPAs contribute to its efforts to combat corporate crime.”106 Indeed, some commentators have questioned whether DPAs and NPAs in practice have been counterproductive in fighting corporate crime: in a 2009 report, “Ethics and Compliance Enforcement Decisions—The Information Gap,” the Conference Board noted the dearth of evidence in DPAs that corporations were given credit “for having effective preexisting (i.e., in existence at the time of the offense) compliance and ethics programs.”107 The Conference Board concluded: “From an ethics and compliance incentives perspective, publicly recognizing settlement-based programs (but not preexisting ones) in enforcement decisions is hardly optimal. In essence, it sends a message that the companies need not be concerned with compliance/ethics programs until after a violation, and thereby undercuts the important law enforcement policy of deterrence.”108

To be sure, any crime might suggest a prima facie case that a company’s compliance program had failed, but given the breadth and ambiguity of federal criminal law, no such program could perfectly eliminate all violations. These ethics and compliance watchdogs argue that companies would develop more extensive compliance programs and ferret out wrongdoing more aggressively if prosecutors more clearly credited preexisting compliance efforts in structuring DPAs and NPAs.

Another concern highlighted by the 2009 GAO report was the fact that judges “were generally not involved in the DPA process.”109 In most cases, the DOJ and its attorneys serve unilaterally as regulator, judge, and jury. Of the 12 judges surveyed by the GAO who had overseen DPAs, nine reported holding no hearings to discuss the agreements’ terms, and ten reported no role in the selection of corporate monitors.110 (Apart from constraints imposed by overcrowded dockets, judges may be loathe to exercise authority when neither side asks it to do so—and companies in any individual case may be hesitant to ask for a judicial role, in fear that a judge might disapprove of the agreement and reopen the prosecution.)

Such lapses confirm the worst fears of the original critics of the proposed federal sentencing guidelines system—namely, that “a sentencing guidelines system [would] simply shift discretion from sentencing judges to prosecutors … [and] that the prosecutor [would] use the plea bargaining process to circumvent the guidelines recommendation if he [didn’t] agree with the guidelines recommendation.”111 In a report with recommendations being prepared for the 20th anniversary of the Federal Sentencing Guidelines for Organizations, the Ethics Resource Center (a nonprofit entity committed to advancing ethical standards in public and private organizations) notes that in crafting the 1984 reforms that led to the creation of the sentencing guidelines, “Congress did not consider … that a previously unknown avenue for resolving organizational cases—DPAs—would develop in which judges would play no role, thus at least raising the question of whether prosecutorial discretion in these cases is undermining the ‘transparency, consistency, and fairness’ that the Guidelines were intended to achieve.”112

Far from ensuring “transparency, consistency, and fairness,” DOJ policy governing determinations about whether prosecutors should enter into DPAs or NPAs has been relatively opaque. Apart from departmental clarification offered through the Thompson, Morford, and Filip memoranda, such decisions are guided by Title 9 of the advisory United States Attorney’s Manual, titled “Principles of Federal Prosecution of Business Organizations.”113 But the “principles” involved are broad and effectively give prosecutors wide discretion in determining whether to enter into a DPA or an NPA: “Ultimately, the appropriateness of a criminal charge against a corporation, or some lesser alternative, must
be evaluated in a pragmatic and reasoned way that produces a fair outcome, taking into consideration, among other things, the Department’s need to promote and ensure respect for the law.”

The serious concerns previously raised by academic commenters, the GAO, the Conference Board, the Ethics Resource Center, and others remain valid: there is no evidence suggesting that DPAs and NPAs have been effective in curbing criminal conduct involving corporations, and there is at least some reason to believe that such arrangements as implemented have been counterproductive in deterring corporate crime by reducing corporate incentives to develop extensive compliance programs.

Additional Concerns

Even if DPAs and NPAs do, on balance, deter crimes involving corporations, it is far from clear that the costs of compliance do not outweigh the benefits to society of such arrangements. Of course, in any individual case, a DPA or an NPA is preferable, from the company’s perspective, to an outright prosecution. The collateral consequences that stem from indictment or conviction can be company-ending in many industries—notably, finance and health care—and risk-averse corporate managers are understandably resistant to bet the company to fight a criminal charge.

Along the same lines, even in cases of clear criminal wrongdoing, prosecutors are understandably reluctant to push companies into bankruptcy—a result that punishes not only a corporation’s shareholders but also other stakeholders, including employees, pensioners, customers, and suppliers. After the stark example of Arthur Andersen, it is hardly surprising that prosecutors have turned to DPAs and NPAs as preferable options to outright prosecutions of large companies. In essence, prosecutors and companies agree to DPAs and NPAs because both have strong incentives to do so.

That DPAs and NPAs are a rational response to the severity of the criminal law does not, however, necessarily mitigate in favor of these arrangements. Precisely because they enable prosecutors to avoid the full consequences of their activities, DPAs and NPAs almost certainly facilitate more sweeping applications of criminal law to perceived corporate wrongdoing. It would seem unlikely that over the course of a few years, the U.S. Department of Justice would take to criminal trial 14 of the Fortune 100 companies—but just that number have been under DOJ supervision through DPAs and NPAs. Such agreements thus seem to abet the government’s significantly expanded application of criminal law to corporate entities—a practice that I have explored and critiqued in earlier writings.

The expanded scope of federal criminal law applied to corporations, facilitated through the dramatic shift toward DPAs and NPAs, has significant implications for the U.S. economy. The potential business costs imposed on companies when federal prosecutors order the sacking of the CEO and other high-level officials—as with Wright Medical—are rather obvious. While there certainly are instances in which management may be harming a company or the broader society through its shareholders, lawyers working for the federal government tend to lack the necessary business judgment to select appropriate corporate managers, and the heavy-handed approach that some prosecutors have used in modifying corporate leadership can have far-reaching economic consequences—particularly given the size of the companies often targeted for DPAs or NPAs. Onerous requirements placed on contracting with outside parties to do ordinary business and refusing to do business with them unless granted access to their books, as was required of Johnson & Johnson in its DPA, is a major impediment to one’s business and a significant competitive disadvantage in the international marketplace. So, too, is the modification of a long-standing sales practice, such as the payment of contingent commissions in the case of MetLife.

In critiquing the economic costs of DPAs and NPAs, I do not mean to suggest that many of the legal rules being enforced by prosecutors are not themselves intended to deter corporate actions that generate social and economic costs of their own. I am not arguing that corporations should be free from regulatory sanction. To be sure, many of the activities alleged in DPA and NPA agreements—including various frauds, bribes, and kickbacks—must be deterred. And individuals
who are themselves involved in such clearly illegal activities should be subject to criminal prosecution.

But corporations cannot be imprisoned, and thus the direct penalties potentially imposed through the criminal law do not vary substantively from those that could be imposed civilly. Rather, the principal differences between criminal and civil sanction lie in collateral consequences to corporations from criminal prosecution, and such consequences are typically so severe that they dramatically strengthen prosecutors’ bargaining power.

Though such expansion of prosecutorial authority might seem salutary to those who believe that businesses are regulated too little rather than too much, the expanded use of DPAs and NPAs, encouraged by the heavy hand of criminal law as applied against corporations, in effect has shifted power from regulators typically employing cost-benefit analysis to prosecutors charged with enforcing bright-line rules. And these prosecutors—well versed in corporate compliance but less so in economics—may be imposing social costs, through DPAs and NPAs, that go well beyond the clear negative impact that such arrangements have on a company’s shareholders and employees. For example, prosecutors’ conception of industry-standard contingent commissions as a type of fraud or kickback was not implausible; but, as noted in the December 2010 paper mentioned above, leading scholars in the law-and-economics literature have defended such payments as important signals for factors highly relevant to purchasers of insurance policies other than price, such as insurer creditworthiness. If such analysis is correct, the NPA reached in the MetLife case may harm not only the company but the broader public that the prosecutorial action was designed to protect. In general, DPAs and NPAs can negatively affect not only a company’s strategy and fiscal health but also the broader stakeholders in the economy beyond the corporation’s equity owners.

The costs of targeting foreign businesses like Tenaris for foreign activities, beyond their impact on the DOJ budget and the potential strain of relations with allies, may be less obvious. But they could include a new reluctance on the part of foreign companies to cross-list their securities on American exchanges, a basis for SEC and DOJ jurisdiction.

Finally, apart from the economic costs imposed, prosecutors’ virtually unchecked powers under DPAs and NPAs threaten our constitutional framework. To be sure, prosecutors are acting upon duly enacted laws, but federal criminal provisions are often vague or ambiguous, and the fact that prosecutors and large corporations alike feel obliged to reach agreement, rather than follow an orderly regulatory process and litigate disagreements in court, denies the judiciary an opportunity to clarify the boundaries of such laws. Instead, the laws come to mean what the prosecutors say they mean—and companies do what the prosecutors say they must. Federal prosecutors are thus assuming the role of judge (interpreting the law) and of legislature (setting broad policy choices about industry conduct), substantially eroding the separation of powers. That such discretion is often delegated to private contractors with sweeping powers—namely, corporate monitors—makes the denial of justice even graver.

V. SUMMARY AND RECOMMENDATIONS

Unfortunately, the problems with DPAs and NPAs are difficult to fix. Companies obviously do not want to face trial—and potential oblivion. Thus such agreements will continue to be struck as long as corporations as corporations are the targets of criminal prosecution. Ideally, Congress would adopt the broad changes to corporate criminality suggested in my December 2010 paper, including requiring actual language in the law on which prosecutors are relying that imputes criminality to a corporation, narrowing the corporate law’s scope to serious predicate offenses by major officials, allowing corporations good-faith compliance defenses, and reducing statutory collateral consequences both in severity and in the preconviction phase of prosecution. The absence of all these things gives most corporations little choice but to comply with demands made by prosecutors in the course of corporate criminal investigations.

But by taking more modest steps to foster judicial and DOJ oversight and by insisting on a rigorous
documentation of DPAs and NPAs and their costs and benefits, current practice can be improved. Such steps could be taken by all three branches of government:

**Legislative.** Congress should insist that the Department of Justice continue to refine and document its handling of DPAs and NPAs. More significantly, to eliminate the potential for prosecutorial error and abuse, Congress should increase judges’ oversight of DPAs and monitor selection and demand a judicial role in determining whether a company has violated the terms of an agreement.

**Executive.** Even without congressional action, the Department of Justice could implement the above recommendations. Moreover, Justice should create a more coherent national framework for such “regulation” by continuing to refine policies and practices governing U.S. Attorneys’ Offices and various divisions within the department. The SEC’s entry into the DPA/NPA field seems ill considered, given the agency’s lack of independent criminal-prosecution authority. While the agency should coordinate with Justice to ensure that its regulatory interests are not compromised through DPAs and NPAs, pushing companies to enter into distinct agreements with the SEC as well as Justice is problematic, with the potential to place conflicting demands on corporations.

**Judicial.** In the DPA context, judges should insist that prosecutors make out a minimal factual showing of evidence and should hold hearings to determine the benefits of an agreement’s proposed terms and their potential costs and risks. Judges should also play an active role in the selection of corporate monitors, if any. Finally, judges should tell prosecutors that any allegation of a breach of a DPA must be confirmed by a judicial finding before any consequences may ensue.

Substantively, such agreements should more carefully and openly consider preexisting corporate compliance programs as a mitigating factor to encourage better business self-policing. Moreover, in general, such agreements should not impose broad requirements on businesses—such as limitations on contracting with third parties that do not open their accounts—that generate severe competitive disadvantages. Such agreements should be careful not to tread heavily on corporate governance, board structure, or business judgment beyond the narrow confines specifically relevant to an investigation, and the use of corporate monitors should be rare. Finally, although prosecutors should be able to prosecute corporate officials criminally for wrongdoing in certain instances, they should otherwise be extremely hesitant to force corporate boards to unseat senior business executives and they should be averse to choosing a corporation’s business leadership.

Notably, the DOJ has substantially refined its use of DPAs and NPAs, largely for the better. It is salutary that such agreements are no longer predicated upon waivers of attorney-client and work-product privileges that compromise individuals’ rights; that prosecutors’ discretion in structuring payments to non-victim third parties has been limited; and that the hiring of corporate monitors has been more carefully controlled and rarer—the latter in practice, if not in policy.

But the number of DPAs and NPAs remains remarkably high, encompassing companies that constitute a substantial share of the U.S. economy. Limiting their scope and sharply curtailing their use—and moving toward a more rational and evenhanded civil and regulatory approach to policing corporate conduct—would benefit the economy and the rule of law alike.
Endnotes


8. See Gibson Dunn 2011, supra note 5.


10. See id. at 4 (“Based on the maxim societas delinquere non potest (‘the company may not engage in criminal activity’), continental European democracies such as Germany and France ‘fundamentally resisted the imposition of criminal liability on legal entities throughout most of the last century.’”) (citing Sara Sun Beale & Adam G. Safwat, What Developments in Western Europe Tell Us about American Critiques of Corporate Criminal Liability, 8 Buff. Crim. L. Rev. 89, 105 (2004)).

11. See id. at 2 (citing Case of Langforth Bridge, 79 Eng. Rep. 919, 919 (K.B. 1635)).


13. William Blackstone, 1 Commentaries *476.


18. See Copland, supra note 9, at 7.

19. See id. at 7 & n.82; cf. Deferred Prosecution Agreement, U.S. Dep’t of Justice, Re: Johnson & Johnson (Crim. Div., Fraud Sec. Apr. 8, 2011), available at http://gibsondunn.com/publications/Documents/JohnsonAndJohnson.pdf [hereinafter “J&J DPA”], at 3 (“Were the Department to initiate a prosecution of J&J or one of its operating companies and obtain a conviction, instead of entering into this Agreement to defer prosecution, J&J could be subject to exclusion from participation in federal health care programs pursuant to 42 U.S.C. § 1320a-7(a).”).


25. Current Justice Department guidance in the United States Attorney’s Manual expressly contemplates collateral consequences in deciding whether to enter into a DPA or NPA. See Dep’t of Justice, U.S. Attorney’ Manual § 9-28.1000 (B) (comment) (“[W]here the collateral consequences of a corporate conviction for innocent third parties would be significant, it may be appropriate to consider a non-prosecution or deferred prosecution agreement with conditions designed, among other things, to promote compliance with applicable law and to prevent recidivism.”).


27. See Copland, supra note 9, at 6 (describing Arthur Andersen’s collapse as having cost the jobs of 28,000 domestic and 85,000 worldwide employees) (citing Elizabeth K. Ainslie, Corporations Revisited: Lessons of the Arthur Andersen Prosecution, 43 AM. CRIM. L. REV. 107, 109 (2006)).


32. See Thompson Memo, supra note 28.

33. See GAO 10-110, supra note 5, at 14, 16.

34. The data for this section comes from the GAO where available, see GAO 10-110, supra note 5; more recent data come from compilations by Gibson, Dunn, see Gibson Dunn 2011, supra note 5; Gibson Dunn 2010, supra note 7.


36. See GAO 10-110, supra note 5, at 34-35.


39. Cf. Robert Khuzami, Remarks Before the Consumer Federation of America’s Financial Services Conference, Dec. 1, 2001, available at http://www.sec.gov/news/speech/2011/spch120111rk.htm (“[N]ot everyone realizes the SEC does not have criminal enforcement authority. We’re a civil enforcement agency. That means our employees carry no guns, we have no handcuffs and we cannot put people in prison. Although we work closely and cooperatively with the Justice Department, bringing criminal charges is their exclusive job.”).

40. See discussion infra, Part I.

41. Justice Department guidelines governing DPAs and NPAs are sufficiently opaque that it is impossible to rule out the possibility that the heavy incidence of health-care- and finance-company agreements stemmed from political targeting of companies in those sectors, owing to public backlash over the 2008 financial collapse and political pressures surrounding health-care and financial-industry reform. That said, the high incidence DPAs and NPAs in the finance and health-care sectors is doubtless substantially attributable to the size of corporations in those sectors and their particularized sensitivity to criminal prosecution as banks and broker dealers and as suppliers

42. See Morford Memo, supra note 22.


46. Id. at 2.

47. See id. at B-1—B-4 (app. B).


49. See id. at 3 (“Were the Department to initiate a prosecution of J&J or one of its operating companies and obtain a conviction, instead of entering into this Agreement to defer prosecution, J&J could be subject to exclusion from participation in federal health care programs pursuant to 42 U.S.C. § 1320a-7(a).”).

50. See id. at 13-28.


52. See J&J DPA, supra note 19, at 5; see also Gibson Dunn 2011, supra note 5.


54. See id. at 33.

55. See id.

56. See id. at 31.

57. See id. at 34-35.

58. See id. at 36.

59. Id. at 32.
60. *Id.* at 35-36.
61. See *id.* at 8-9.
62. See *id.* at 9.

65. See generally Wright Medical DPA, *supra* note 63.
66. See *id.* at 15-16.
67. See *id.* at 11-13.
68. See *id.* at 1.
69. *Id.* at 3-4.
70. *Id.* at 5-6.
71. See *id.* at 5, 14.
72. *Id.* at 16-17.
76. *Id.*
77. *Id.*
78. *Id.*
83. See id.; Tenaris NPA, supra note 81.
84. Tenaris NPA, supra note 81, at 1-2.
85. Id. at B2-B3.
86. Id. at B2.
87. Id. at B3-B4.
88. Id.
89. See Tenaris SEC DPA, supra note 82, at 1-2.
90. See id. at 8.
91. Id.
92. See id. at 9.
93. See Tenaris NPA, supra note 81, at A1, A3; see also Tenaris SEC DPA, supra note 87, at 3-5.
94. See, e.g., Ambramowitz & Bohrer, supra note 31.
97. See Coffee, supra note 23.
103. 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 (“Senator Leahy, chairman of the Senate Judiciary Committee, recently expressed disappointment that the Morford Memo does not address the potentially excessive compensation of monitors or other issues such as a monitor’s reporting requirements.”).

106. GAO 10-110, supra note 5, exec. summary.


108. Id. at 3.

109. GAO 10-110, supra note 5, exec. summary.

110. Id. at 25-26.


115. See Copland, supra note 9, at n.96.


119. See Copland, supra note 9, at 9-10.
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