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What Exactly Is a Corporate Monitor?

From the Experts

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With high-profile Ponzi scheme cases such as those involving Bernie Madoff and Scott Rothstein being front-page news for several years now, the public has grown accustomed to court-appointed fiduciaries such as bankruptcy trustees and receivers. But there is another type of court-appointed fiduciary that is less known but equally effective—the corporate monitor. In-house counsel should take note.

So what is a corporate monitor? Like a receiver or trustee, a corporate monitor is a lawyer, accountant or other disinterested professional appointed by the court as a neutral third party. However, unlike a receiver or trustee, who typically has expansive powers (and thus potentially more costs), a corporate monitor traditionally performs a specific set of functions or has a single-purpose duty. For example, the court (whether state or federal) may appoint a corporate monitor to continue operating a business for a specified duration as the litigants fight it out in court. In this context, the corporate monitor typically oversees the actions of the company's management to prevent destruction of documents, dissipation of assets or other inappropriate behavior.

The benefit to management and in-house counsel in this specific context is that management is not entirely displaced, but is simply supervised by a court to maintain the status quo. The result is a preservation of control and direction of the company, which should be the goal of in-house counsel under the circumstances. A receiver, on the other hand, will most likely displace management, leading to a loss of control and direction by management and in-house counsel. Loss of control and direction is usually the last thing any in-house counsel will want for the company or one of its subsidiaries.

Another important factor is that with a corporate monitor, who is supervising but not managing, there will be fewer costs than with a receiver, who is doing both. Therefore, in-house counsel should be mindful of the benefits of a corporate monitor, especially when opposing the appointment of a receiver. If the business is no longer operating, the court may appoint a corporate monitor to simply hold assets or serve as a liquidating agent to repay creditors. No matter the situation, the corporate monitor's main focus is to preserve the status quo of the business, the entity or the assets he or she has been appointed to oversee.

One trend for the innovative use of corporate monitors is in the realm of securities fraud or other investment-related scams. A government enforcement agency, such as the U.S. Securities and Exchange Commission, the Federal Trade Commission or the U.S. Commodity Futures Trading Commission, may need months to fully investigate a potential fraud or scheme. At the same time it may harbor serious concerns that its potential target may dissipate investor funds during the investigation. If the agency cannot wait for its investigation to be completed and wishes to file suit immediately to displace the current management from maintaining control, the agency may request the immediate appointment

of a corporate monitor to ensure that assets are preserved. Alternatively, if the corporation or entity under investigation is concerned about the impact that a receiver may have on a potentially viable business that has been (or is being) mismanaged, it can voluntarily relinquish control to a neutral corporate monitor in an effort to cooperate with the investigation.

Again, preserving the status quo is the goal and typically is achieved by creating effective oversight of potential inappropriate activity, such as corporate looting, further loss of funds and/or document destruction. The corporate monitor, therefore, can be not only a financial watchdog to save company or investor funds, but also an overseer to improve the company's internal controls and corporate governance, and ultimately garner a more favorable outcome in a settled regulatory action.

The defunct Florida hedge fund OM Global Investment Fund LLC is a good example of when a corporate monitor made sense. In spring 2013, investors of OM Global were owed approximately $14 million, which OM Global had raised for purportedly investing in Facebook's pre-IPO stock. Complicating things was the fact that the hedge fund, through its principal and sole trader, Gignesh Movalia, had suffered massive trading losses of approximately $9 million, had liquidated all open trading positions and had failed to initially register properly with the SEC. With the SEC still investigating, a corporate monitor—as opposed to a receiver—was the most efficient solution to remove management, preserve the remaining investor funds and distribute them to repay the nearly 200 investors who were owed money.

As a result, a lawsuit was initiated in May 2013 in Miami-Dade Circuit Court by an investor to appoint a corporate monitor. Judge Daryl Trawick was assigned the case and appointed as OM Global's corporate monitor one of us: former SEC senior enforcement counsel James D. Sallah of the firm Sallah Astarita & Cox. Sallah retained our firm, Levine Kellogg Lehman Schneider + Grossman, as his legal counsel, in part due to our experience as court-appointed receivers. The team understood the immediate benefits to investors of having a corporate monitor appointed in the interim of the government's investigation.

The team quickly identified and communicated with all known investors, compiled and reconstructed the necessary bank records to determine a cash-in/cash-out analysis of what investors were owed, and developed a court-approved claims and distribution procedure for repaying investors. Nearly 200 purported investors and creditors ultimately submitted claim forms. Last April, the team made its first distribution of approximately $2.3 million to investors with allowed claims. A second distribution will take place in the future. The corporate monitor's appointment had accomplished the primary goal of securing investor funds to repay them—i.e., preserving the status quo—in the interim of the SEC's investigation.

However, what was expected to be a limited monitor proceeding of identifying and repaying investors turned out to be much more than that. Millions of dollars in purportedly unauthorized loans had been made with investor funds and were still owed to OM Global. At the same time, millions of dollars in allegedly improper redemptions to investors had been made as well. The Facebook investment in which investors believed they had invested had not existed for many months. Allegedly false account statements had been sent to investors. The dire nature of the fund had been covered up to keep investors in the dark for as long as possible.

The appointment order in OM Global accounted for these contingencies, so the corporate monitor had certain expansive powers traditionally granted to receivers and trustees, such as the ability to sue third parties. As a result, the corporate monitor has sued several targets, including loan obligors and investors who purportedly received improper redemptions, and has settled pre-suit with several others. The investor lawsuits seek the return of purportedly overpaid funds, including principal, from investors who purportedly knew or should have known that OM Global was a Ponzi scheme and/or who knew or should have known that their redemption amount was improper.

The next time expediency is required under the circumstances, a corporate monitor may be the best solution. Moreover, if a full-blown receivership may potentially harm the defendants, a corporate monitor who provides oversight of potential inappropriate activity may be the most efficient and cost-effective answer. Because, in many instances, you do not know if funds were misappropriated or if "clawback" claims will be necessary until after the appointment, it makes sense to include—in an abundance of caution in the appointment order—the power for the corporate monitor to sue on behalf of the entity. And if any additional powers are needed later on, the appointment order can always be amended—with court approval, of course—to include the needed powers.

In litigation, your company may never face a requested receivership or other fiduciary court appointment. Management and in-house counsel would certainly welcome the prospect of never finding itself in that position. However, it can never hurt for in-house counsel to understand and remember the option, and potential benefits, of alternative court-appointed fiduciaries such as the corporate monitor.

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