Today's
GENERAL COUNSEL

COMPLIANCE PLANS SHOULD REDUCE RISK NOT CREATE LIABILITY

By Michael G. Considine and Christopher M. Favo

Calls for improved corporate compliance are coming from boards of directors, shareholders and the government. The media regularly reports on prominent compliance failures. Much of this has to do with whistleblower provisions that are part of the Dodd-Frank legislation, and qui tam provisions under the False Claims Act. Both reward employees for reporting corporate misconduct.

Board members are now exposed to personal liability for failing to ensure that compliance measures are deployed. Outside and in-house counsel constantly remind upper management that legal developments around the globe demand focus on compliance. They refer, for example, to the UK Bribery Act, which includes provisions enabling companies to avoid criminal liability for unlawful employee conduct if a valid compliance program exists. They recount recent Department of Justice initiatives, and the prospect that in coming years similar provisions will surface across the globe. Given these developments, there is little corporate resistance to the concept of implementing a compliance program.

Nevertheless, given cost and other pressures, after committing to crafting a compliance program, companies may patch one together with insufficient planning. They may deputize personnel with little compliance experience, and no reporting lines to the board, to spearhead the compliance initiative, and then add that task to their normal business functions.

Those "compliance officers" may get a limited budget and inexperienced staff. They may have the compliance function thrust upon them without adequate training, and they may be given a copy of the compliance program of an established competitor and encouraged to use it to fashion a new plan. Such steps may enable management to "check the box" and report to important constituencies that compliance is a priority and that a formal plan is in the works.

That approach may prove lethal. While the competitor's company may be similar in some respects, it likely has substantially different risks, and replication of its compliance plan is probably misguided. For example, the risk profile of a company that delivers products to the Middle East cannot be compared to one that ships only to the United States and Canada. Nor can a company in the food industry be analyzed with respect to a similarly sized operation in the oil industry.

When such comparisons are made, poorly crafted compliance plans emerge, and various provisions of the plans are ignored because they are too impractical to implement. Additionally, reporting and auditing provisions may be deemed too burdensome to follow. All of this may occur because the templates used to craft the plans were off the mark.

Even provisions that are neither impractical nor burdensome may be deliberately ignored for other reasons. For example, provisions regarding the imposition of disciplinary measures following the discovery of misconduct may sound authoritative when crafted, but are subject to being side-stepped when the behavior of important business leaders is scrutinized.

The rationale for bypassing provisions of a compliance plan may appear justifiable at the time. But once the plan is analyzed, typically after misconduct occurs, its weaknesses will be apparent, and these weaknesses are precisely what government investigators and plaintiffs' counsel can easily exploit. For example, the failure to conduct annual anti-bribery training mandated by a compliance plan will be hard to explain when seeking to resolve a DOJ investigation of employees who bribed foreign officials. And the failure to conduct due diligence on a third-party vendor as required under a plan will prove problematic if products shipped to an unrestricted country suddenly appear in sanctioned countries.

On the civil litigation front, a company's failure to discipline a valued supervisor for serious misconduct involving subordinates might effectively arm plaintiffs' counsel in a subsequent discrimination lawsuit.

In addition to the risk that government regulators and plaintiffs' counsel can exploit these weaknesses, there is a risk that internal erosion will occur if a poorly crafted plan is implemented. Compliance officers will lose credibility if they seek to enforce unworkable provisions. Rank-and-file employees, in turn, will view the company's overall compliance efforts as hollow.

Given such consequences, if a company doesn't ensure that a compliance plan addresses the real risks the company confronts, and that employees can follow it in practice, one might ask whether the company is better off with no plan at all.

Developing a truly effective compliance plan can enable companies to stop improper conduct early and reduce the likelihood or impact of civil lawsuits and government probes. There are times when the benefits of such a plan may be demonstrable, as a major financial institution learned after enduring an extensive DOJ bribery investigation into its problematic Asian business operations. After analyzing the robust application of the company's well-designed compliance program, the government opted to prosecute the individual employee but not the company, given the latter's extensive compliance efforts.

In so doing, DOJ observed: "After considering all the available facts and circumstances, including that [the financial institution] constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the [DOJ] declined to bring any enforcement action against [the company] related to [the employee's] conduct …"

DOJ maintains that similar decisions have been made in other cases, though the details cannot be publicized.

It's true that the benefits of an effective plan may not always be so easily discernable. Obviously it is challenging to identify misconduct that would have occurred but for the existence of a plan. Moreover, an effective plan will not necessarily halt all improper conduct. Even in the best of companies, the formation of effective auditing processes does not eliminate embezzlement, and the creation of environmental, health and safety departments does not halt all illegal dumping.

But a compliance plan can and should be effective. Its implementation should be undertaken with the same rigor that's employed when contemplating the launch of a new business line, or expansion into a new region. It requires, among other things, appointing compliance officers with stature and experience; equipping them with adequate resources; and providing them with a direct reporting line to the board or upper management. It requires developing a corporate culture of compliance, from the top down, and establishing procedures and processes that are workable.

It's important to focus substantial efforts on areas posing the most risk. Assessing risk requires a comprehensive review of the business lines, the federal statutes implicated in the business operations, the countries involved and their reputations for corruption. Vendor relationships should be reviewed, as should particular practices closely scrutinized by the government. Existing, threatened and potential lawsuits and regulatory probes should be reviewed, and consideration given to conducting such planning in a privileged context.

After establishing a plan that addresses the identified risks, an experienced internal team should be tasked with responding to complaints that surface, and an outside legal team should help fashion appropriate responses to questioned behavior – not make problems worse.

Formation of the plan should not end the process. It must be regularly reviewed. Staffing and budgets must be carefully monitored to ensure compliance remains a priority. The plan should be audited, and changes should be made as the business and the risks evolve. By taking these steps, the resulting plan will more likely be deemed effective, both on paper and in practice, and will reduce risk, not increase it. ■

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December/January © 2014 *Today's* GENERAL COUNSEL

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