

703: Legal Risk Management Policies & Procedures

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Legal Risk Management: Regulatory Risks

- Regulatory risks are omnipresent.
 - Certain regulatory risks are common to all business enterprises. However, their importance to a particular company or type of business may vary greatly.
- What do we (I) mean with the term regulatory risk?
 - Risks associated with government regulation of corporate behavior.
 - Regulatory oversight is handled by a specific government agency or agencies.
 - Examples include: competition or antitrust law, health and safety regulation

Regulatory Risks: Potential Impact

- Regulators can kill a company as quickly (perhaps more quickly) than tort lawyers or a hostile takeover. Ask Arthur Andersen.
- Criminal charges are usually part and parcel of the law setting up a regulatory environment.
- This is not just the case in the US but in Europe and throughout the world as well.
 - Pay attention, however, legal cultures vary. What is criminal in one jurisdiction may not be criminal in another and vice versa.
 - Fines can be significant, facilities can be closed, outside monitors can be appointed

The regulatory/criminal nexus in the US

- Corporate indictments for regulatory problems are a continuing phenomenon in the US (and not only the US).
- Examples include:
 - Schering-Plough Corporation for health care fraud.
 - Citgo Petroleum Corporation: violation of environmental regulations.
 - Milberg Weiss & Bershad (a law firm): mail fraud
- Criminal prosecutions for regulatory infractions are not unknown in Europe.
 - Labor law, competition law, health and safety and privacy laws are but a few examples of areas where corporate officers risk jail time. (Although the risk for the corporation is less than in the US.)

Civil sanctions can be almost as serious: two examples

- ITT, a major US defense manufacturer and the leading supplier of night-vision equipment to the US military.
 - Criminal charges from the Department of Justice for violating US export control laws.
 - USD 100 million in fines, deferred prosecution, commitment to implement burdensome internal compliance program.
 - Debarment from US government contracts and revocation of export privileges (however, carve-outs for national security reasons); agreement with Department of State not yet released.
- GE Medical Systems
 - Utah-based plant was shut-down by the FDA
 - Consent agreement prohibits manufacture and distribution until company complies with federal law.

The Thompson Memorandum and the McNulty Memorandum

- The Thompson Memo dating from 2003 set forth criteria further to which the Department of Justice would pursue criminal actions against corporations.
- Replaced December 2006 by the McNulty memorandum.
 - Waiver of attorney-client privilege
 - Production of results of internal investigations
 - Denial of payment of attorney fees for employees under investigation were concerns that were addressed.
- Will not change, however, the trend further to which corporations resolve corporate criminal investigations without indictments or trials.

Outline of Regulatory Risk Management Program

- Determine the regulatory risks that your company faces.
 - Many will be known but others will need to be assessed.
 - Internal due diligence will raise awareness.
- Evaluate the threat level emanating from each category of regulatory risk.
- Understand the applicable laws and regulations.
- Understand how your peers address these risks. What are the best practices?
- Prepare a risk mitigation program or compliance program.
- Implement, while continuing to train, audit, monitor and improve.

Regulatory Risks: What are they?

- Areas of concern are almost limitless.
- Will vary depending on the company and its area of operation. Will need to be continually updated.
- Examples, include:
 - Competition law, antitrust
 - Securities laws (including corporate governance)
 - Employment and labor laws
 - Environmental
 - Export controls (including customs)
 - Trade controls
 - Safety and Health
 - Industry specific (for example, medical, pharmaceutical, telecommunications, etc.)

Regulatory Risks: Evaluating the level of risk

- Will vary over time and depending on jurisdiction
- Risks will need to be evaluated on a subject area basis and on a jurisdictional basis.
- Once the subjects and the jurisdictions are identified, the nature of the risk and the level of compliance will need to be determined.
- Resources will need to be focused on areas where compliance is lacking.
- Evaluation will need to be redone on a periodic basis. Laws change, enforcement priorities change, companies change.

Keeping up to date and training your company

- Not easy, to say the least.
- Priorities need to be set: major banks will devote billions to the process, smaller companies will necessarily devote less.
- Legal organizations, law firms are excellent sources as are the numerous providers of compliance programs and materials (these have costs—the first two categories may be relatively less expensive).
- Identify those laws and regulations of paramount concern and keep updated yourself.
- Develop a personal network within your industry and within subject areas of concern.
- Computer based training is effective even for smaller companies.

Corporate Compliance Programs, Charging criteria

- Nature and seriousness of the offense, including risk of harm to the public;
- Pervasiveness of the wrongdoing, including complicity or support of management;
- History of similar conduct;
- Timely and voluntary disclosure of wrongdoing and willingness to cooperate in the investigation;
- Adequacy of pre-existing corporate compliance program;
- Corporation's remedial actions (including implementing effective compliance program or improving an existing one);
- Collateral consequences;
- Adequacy of charging individuals; and
- Adequacy of other enforcement remedies (e.g., civil remedies).

Corporate Compliance Programs: Characteristics

- An effective regulatory compliance program directed at achieving high standards of compliance by a business organization is characterized by eight principles:
 - Well-designed standards and procedures (internal controls) to detect problems or violations, whether inadvertent or not that are subject to continuous improvement;
 - Knowledge, understanding and support of compliance operations and the exercise of reasonable oversight of the compliance activity—the compliance activity must be managed by persons with authority in the organization;
 - Reasonable efforts not to include within the organization, or as agents or affiliates, individuals or entities who have engaged in conduct inconsistent with ethical and compliance standards;

Corporate Compliance Programs: Characteristics (contd.)

- Reasonable measures to communicate standards, goals and processes to employees, agents, affiliates and business partners of the organization through dissemination of information and provision of training and appropriate resources;
- Reasonable steps to ensure the compliance program is adhered to by: (a) monitoring and auditing, (b) systematic (not ad hoc) evaluations, (c) transparency and (d) other methods for identifying problems (ombudsman, hotlines, etc.)
- Reasonable efforts to promote and enforce compliance programs throughout the organization by, perhaps, the use of incentives and penalties;
- If violations or problems are detected, timely efforts to resolve the matters and prevent recurrence, including changes to the compliance program as needed;
- Procedures for timely reporting of self-discovered violations to the appropriate authorities.

Corporate Compliance Programs: Internal Control Standards

- Control environment: Includes clear lines of authority and responsibility, effective hr policy and maintenance of relationship with regulators.
- Risk assessment procedures: continuous evaluations of the compliance program and recognition that risks are not static;
- Control activities: policies, procedures and mechanisms including:
 - Authorizations, verifications, recordkeeping, etc.
 - Such control activities are increasingly automated to improve efficiency and effectiveness.
- Information and communications
- Monitoring: by both internal and external audits as appropriate.
 - N.B. Invasive monitoring is a characteristic of many consent agreements.

Corporate Compliance: Competition rules for supply and distribution agreements in Europe

- An area of concern for most businesses active in Europe.
- As such, it should be dealt with in a corporate compliance program. Risks of non-compliance are great.
- Elements will include an understanding of:
 - Vertical agreements
 - Agency agreements
 - The Block Exemption Regulation
 - Requirements for application of the Block Exemption Regulation
 - Hardcore restrictions
 - 30% market share cap
 - Specific conditions
 - Withdrawal of BER
- Competition DG Guidelines
- Criteria for the assessment of the most common vertical restraints
 - Single branding, exclusive distribution and exclusive customer allocation, selective distribution, franchising, exclusive supply, tying, recommended and maximum resale prices.

Insurance: a few words

- An integral part of any legal risk management program.
- Need to determine which risks can be insured against and which cannot. Directors and officers liability covers a number of legal risks.
- Legal departments are not always closely involved with the insurance process—they should be.
- Insurance policies are complicated contracts. The applicable law matters greatly. Local practice also matters, insurers are sued much more often in the US than they are in Europe.
- Limits of coverage, exclusions and exceptions need to be examined carefully.
- Which broker and which legislation are major issues for multinational businesses.