

Corporate Crisis: Dealing with the Regulator

CREATING A REGULATORY DEFENSE STRATEGY

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When the regulators stab you in the back

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(...) I'm not going to be very specific here but this is a situation faced by a great many companies who are closely regulated by oversight organizations at the state, federal or local level. This could apply to financial regulators, utilities, industry for a variety of things including environmental, even tax issues.

In this situation the **company was bending over backwards to address all the concerns that the regulatory agency was raising**. They knew there was a problem and proactively discussed and brought all the relevant details to the agency representatives attention. **And the agency folks were highly complimentary about the company's cooperativeness, transparency and proactive planning** to address the concerns. But the governor needed to make some hay apparently. Or answer to critics about the toughness of the agency on industry.

So, while the nice talk continued in the conference room, **the agency's communication people went to work crafting a press release designed to make the company look like it wore horns and waved a forked tail**. The word had come down apparently—make us look good by making them look really bad.

There was some cooperative work on the press release, a slight toning down of the hyper aggressive tone and implied name calling, **but by the time it hit the media it was ugly**. What is the company to do? Publicly call out the fact that they have been stabbed in the back by agency folks answering to a higher authority? There is nothing they can do except see all their hard work to be cooperative, to be proactive, to be responsible citizens go for nothing as it relates to their reputation.

Think this can't happen to you? I've seen it over and over and over—with big companies and small companies. And the threat is not you as a company making a mistake—but the politicians who control these agencies looking desperately for any opportunity to make themselves look good at your expense

Stakeholders

<i>Segments</i>	<i>Financial impact</i>	<i>EHS concerns if applicable</i>	<i>Main agenda</i>	<i>Secondary agenda</i>	<i>BCP Action</i>
Public at Large		General agreement with defense of the environment(*)	News item, rage, headlines, scandal	Legacy to future generations	Management of perception – rebuild reputation
Customers	Seek alternative suppliers	Product safety concerns	Loss of trust in our other lines	Continuity of product	Transparency and incentives
Neighbors	Property losses and value	Long-term exposure/stigma	Recurrence	“NIMBY” anymore	Outreach initiatives
Shareholders	Investment value loss		Loss company pride		Reassure markets
Media	Increased sales and additional revenue		Bias of some against big business	Ratings + readers & viewers	Media strategy
Banks	Defaults – risk of foreclosure		Preference for other businesses	Impact on valuation	Reassure analysts
Government	Remediation costs (taxes)	Damage control and cleanup	Nationwide/Intl image	Reelection	Public Affairs strategy
Politicians		Concern if impact on image	Voters vs. job losses	Reelection - local support	Engagement through PAC
Regulators	Amount and nature of fines and penalties	Repair damages and prevent recurrences	State of personal relationships with company	Survival	<u>Regulatory Defense strategy</u>

Before a crisis event

- Before the crisis event, drive the design of a “Regulatory Defense” strategy
- Prepare for the worse
- Accept a future crisis as a certainty
 - Steer your client today towards acting with corporate responsibility
 - Emphasis on compliance with applicable statutory regulations
 - Adopt world class practices and policies, and execute effectively on them
- Document your ongoing compliance efforts
- Always conduct yourself with the utmost integrity and ethics

Before a crisis event (2)

“Know your Regulator”

- Adopt a single point of contact with the regulator and keep a communications log
- Develop a good working relationship with the regulator representatives (all levels)
- Design a Public Affairs plan and make the regulator a part of it
- Educate the regulator about you and your good conduct
- Learn and address the regulator’s concerns
- Participate in the industry association and invite the involvement of the regulator

Before a crisis event (3)

● Welcome “peace time” investigation and enforcement activity

- Don't go as far as inviting audits, but do not resist them
- Negotiate conditions with an amicable approach
- Gather all relevant files and make appropriate resources available to inspectors
- Be careful not to overdo it – be mindful of your company's legal position and interests
- Work with the regulator to address confidentiality issues
- Monitor investigation to predict outcome

The crisis event happens – first steps

- **Execute your BCP (media, public)**
- **BCP must include Regulatory Defense strategy**
 - Types of crisis – different approaches
 - Natural disaster
 - Industrial accident
 - Environment release
 - Media investigation
 - Allegations by customer, employee or competitor
 - Sabotage leading to catastrophic consequences

Regulatory Defense - battlefronts

- **Securities** – press releases and disclosures
- **Criminal charges**
 - Individuals
 - Enforcement Actions by DOJ or equivalent
- **Industry-specific regulatory action**
 - Example: in the event of a environmental discharge in the United States: EPA and state NRC

Best practices in Regulatory Defense

- Before the crisis: prepare a detailed “vulnerability” study
- Include an analysis of your stakeholders – understand their agenda
- Engage your stakeholders before a crisis event takes place
 - Includes not just the regulator, but also the community, consumers, industry, and suppliers
- Practice your response in collaboration with your stakeholders (not in isolation)

Give the regulators and your stakeholders a **sense of confidence** – a crisis event will be handled in a competent, responsible, effective and safe manner **with the interests of the stakeholders in mind.**

Best practices in Regulatory Defense (2)

- **After the crisis event, adopt a “full cooperation” discourse**
 - Gather all pertinent facts for the regulator
 - Prepare an objective analysis of facts and circumstances
 - Provide evidence of compliance to make your mitigation case
 - Do not impair the legal position of the company

Regulatory Defense communications

<p>Public and media</p>	<p>Inform that a crisis event has occurred Provide a brief report on what is known, and what is the company response Anticipate service disruptions / negative impact of the event Provide the different stakeholders with several alternative means to contact the company for further information, and resources for assistance to injured parties Promise an update as soon as additional information is available Follow up</p>
<p>Regulatory authorities</p>	<p>Admit that an event has taken place but do not assume responsibility Express willingness to deal with the event and mitigate damages Warn of significant service disruptions and other negative impact Express desire to negotiate terms of appropriate disclosure with relevant regulators Explain how the authority will be kept informed Explain how the company is communicating with its stakeholders Provide a report of anticipated cost to deal with event Invite the regulator for follow up meetings and a collaborative effort Follow up</p>

Regulatory Defense – role of legal

● **Prior to (and during the crisis),
monitor the environments in which
your company does business**

- Industry environment
- Regulatory environment
- Stockholder issues in your annual meeting
- Edgy business practices (remember Enron?)
- NGOs
- Product issues
- Internal issues

Regulatory Defense – role of legal (2)

- **After the crisis event, assume an active role**
 - Be a part or even coordinate the investigation
 - As a lawyer, you know what matters in making the case for the Regulatory Defense and other fronts
- **Preserve your ability to assert attorney-client privilege regarding all evidence**
- **Be the sole channel of communication with government attorneys**

Regulatory Defense – role of legal (3)

- **Take the lead in preservation of evidence**
- **Witnesses**
- **Ensure key documents are preserved and record retention policies – scheduled destruction is suspended**
- **Split samples or copies for independent testing**
- **Training of employees – legal impact of their activity and statements (e-mail!)**

Regulatory Defense – role of legal (4)

- **Decide on whether to issue a preliminary findings report – careful about disclosing privileged information**
- **Develop litigation strategy**
- **Continue executing regulatory defense strategy**
- **Formulate recommendations for the future – past experience and industry best practices**

Regulatory Defense – Role of Legal (5)

- **Prepare the “good compliance record” case**
- **Compliance as requirement - leniency treatment**
- **“Unforeseeable – company not to blame”**
- **We did everything possible to prevent event**
- **We acted in good faith going above and beyond statutory compliance requirements**

Regulatory Defense - resources

- **Crisis expertise (planning and management)**
 - Internal
 - External
- **Consultants (on speed dial)**
 - Seek help – external counsel (but watch the budget)
- **Support functions**
 - Corporate aviation, finance, logistics, etc.

Regulatory Defense – other resources

- **Recruit third party supporters**
 - Independent experts, grass-root networks, think tanks, regulators in other states or countries
- **Counsel with contacts and experience dealing with the regulator**
 - Identify firms with the right expertise prior to the crisis
 - Train them on your company policies regarding integrity and ethical practices

Regulatory Defense - Recommendations

- Better treatment by the regulator if members of RD team have **prior interaction with key individuals within the authority**
- Better approach to the management of the crisis if RD team has **members with cross-disciplinary backgrounds**
- Better analysis and recommendations if RD team has **prior knowledge of subject matter**
- Better response if RD team has **good rapport with third parties**
- Better results if organization has a **prior effective crisis management plan in place**
- Don't let the meetings/calls become a **Gladiator fight**

Regulatory Authority

- **Varying degrees of competency and involvement**
- **Political institution – politics drives their decision-making process**
- **Emotional intelligence issues of the individuals involved**
- **Dealing with the regulator is not a science - its an art**

Regulatory Authority – Policy approach

- **Regulatory enforcement policies designed to punish deceit and negligence**
- **Failure to report is almost as bad as causing the event**
- **Authority will attribute to the company the intention to circumvent regulations**
- **Severity of penalty increases**

Regulatory Authority – state of mind

- **What the regulator can do vs. what they think they can do**
- **Motivation and incentives**
 - Survival of the bureaucrat
 - Hero of the people
 - Just a technocrat
- **Pressure from all directions**

Regulatory Authority – powers and tactics

- **Statutory power of the regulator**
- **Counsel for the regulator - discovery**
- **Censorship**
- **Meetings / official hearings**
 - Rules
 - Independent representation for employees
 - Physical evidence

Regulatory Authority – media relations

Regulators may be media savvy

- Examples in the United States: DOJ, SEC, NY State Attorney

Same considerations when dealing with media apply to dealing with these regulators

- Regulator will use our feedback to craft their own strategy
- Need to manage our media and the regulator's access to media
- Better to cooperate with the regulator and have a joint media strategy

The regulator's POV – an example

- **First response**
- **Receive company incident report**
- **Document the incident**
 - What, when, how (cause)
 - Ongoing
 - Casualties
 - Level of threat to nearby communities
 - Company's BCP and progress of plan
 - Recommendations for future action

The regulator's POV – an example (2)

● Investigation phase

- Review incident details – verify company info
- Determine root causes and conditions
- Produce final incident report with evaluation of company policies, execution and response
- Formulate recommendations to mitigate or repair damages and prevent future occurrences
- Recommend sanctions

The regulator's POV – an example (3)

- **Special incident /violation report**
 - Depends on procedure established by agency
 - Serves as basis for enforcement action
 - Describes facts and is basis of government's case
 - Work closely with regulator to ensure fair and balanced treatment of fact and company conduct in the report

The regulator's POV – an example (4)

● Monitor company response to incident

- Review and approve remediation plan
- Evaluate cleanup targets and monitor compliance levels
- Perform field tests to evaluate nature and extent of damage
- Request periodic reports from the company

Enforcement actions

● Principle of “progressive enforcement”

● Basis:

- Violations are usually product of misinterpretation of regulations
- Unintentional acts should be treated with leniency
- Willful disregard of regulations, recommendations, best practices are serious breaches of trust and deserve swift punishment

Enforcement actions (2)

● Progressive enforcement - sanctions

● Options:

- Notices/citations/administrative orders
- Penalties
- Suspension of activities
 - Suspension of right to do business with government
- Revocation of license to operate or conduct business
- Forfeiture of assets
- Prison

Enforcement actions (3)

● Sanctions – factors taken into account by the regulator:

- Record of compliance
- Disregard to prior warnings
- Deliberate intent to circumvent regulatory requirements
 - Maintenance failures/substandard equipment
 - Unsafe operations/ improper measures to prevent contamination
 - Evidence of previous incidents not reported
- Extent of damages caused by the event

Enforcement actions (4)

● Calculation of penalties:

- Savings benefit to the company derived from non-compliance
- Willful disregard of regulations/warnings/best practices
- Failure to use common sense
- First offense vs. repeat offender
- Extent of damage/quality/effectiveness of company response
- Costs incurred by the company under remediation plan and losses (but not if willful disregard)

Regulatory Defense – end game

- **Repair damage (relationships, physical, reputation)**
- **Neutralize negative impact of enforcement**
- **Minimize fines and penalties**
- **Avoid long-term sanctions or restrictions**
- **Survival of the company and management**
- **Everybody saves face**