CONFLICTS OF INTEREST:
IDENTIFYING THE RISKS AND
MITIGATING THE HARM WITHOUT
UNNECESSARY RESTRICTIONS

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What are conflicts?

- An incompatibility between one's private interests and one's public or fiduciary duties.
- Personal v. Company (Organizational) Conflicts
  - Personal – conflicts between employee and company
  - Company – conflict between company and customer or other third party to whom company owes some duty
    - Government contracting
    - Spitzer financial services cases

Complex and challenging

- Complex area of compliance law
  - Lack of unified law
  - Amorphous nature of concepts
  - Wide scope of activities prone to conflicts
  - Highly personal context in which conflicts arise
  - Discretionary nature of transactions
  - Ability to conceal conflicts of interest
  - Failures can diminish credibility of the program (and corporate culture) as a whole
  - Frequent perception of double standards
  - Apparent conflicts are often just as damaging as actual
Risks Created from Conflicts

• Skewed judgment/poor decision-making
• Diminished effort
• Disclosure or misuse of confidential information
• Creation of inappropriate work environment
  • “I hear that in ____ they are all related to each other. It makes it hard to get good information. It even creates fighting between groups. It is a big problem.”

Risks Created from Conflicts

• Corrosion of culture/perception of lack of fairness
• Systemic integrity
  • “When conflict-of-interest situations are not properly identified and managed, they can seriously endanger the integrity of organisations and result in corruption in the public sector and private sector alike.”
  • OECD Guidelines on Managing Conflict of Interest in Public Service
Lessons from Corporate Law: Duty of Loyalty and Interested Party Transactions

• At early common law, transactions between a director or officer and the corporation were voidable regardless of the fairness of the underlying transaction.
  • Remove all temptation and protect the corporation
  • Not practical, and increasingly more impractical
• Now, challenges to transactions involving director or officer conflicts require a showing that:
  • transaction was approved by shareholders or by fully informed disinterested directors (procedural fairness) or
  • transaction is fair to company (substantive fairness)

Oversight of Conflicts Standards

• Typically ultimately resides with CECO, including ownership of
  • Policy interpretation, revision
  • Certification/questionnaire process
  • Pre-approval process
  • Investigations of suspected non-compliance
  • Training and communications
  • Discipline and enforcement
• Implication for COI regimes: Independence and authority of CECO/C&E Program are critical
Conflicts Policies: Specificity v. Flexibility

• General principles to guide the program
  • Policies broad enough to provide flexibility
• Providing a certain level of specificity, e.g.,
  • Address specific risk areas
    • Financial interests
    • Working for business partners or competitors
    • Family members at the company or in the industry
    • Personal use of company property
    • Corporate opportunities
  • Definitions of family
  • Gift and entertainment standards

Training and Communications

• Can be challenging to develop appropriate training because
  • Breadth of area and
  • Varying legal standards
• Helpful to focus on impact/harm
• Organizational justice issue
  • Employee perceptions of COIs by managers and senior leaders undermine C&E program as a whole
• Should stress recognition and disclosure
• “Localized” hypotheticals and case studies
• Actual stories can be particularly effective
Training and Communications

• For the board of directors, consider covering three areas:
  • Their own COI risks, such as
    • Corporate opportunities
    • Transactions with the Company
  • Monitoring the COIs of senior executives
  • Oversight of the COI program
    • Consistent with their Caremark duties

Questionnaires/Certifications

• Increasingly used for either high-level or all employees
• Typically require employees to certify that they
  • have read and are familiar with the COI policy
  • are not aware of policy violations during past reporting period or have reported suspected violations
• May review the COI policy at a high level or by risk area
• Provide an opportunity to report
Approvals

- Central approval (e.g. ethics or law office)
  - Safety in numbers
  - Decision by committee?
  - Lends a certain level of independence
- Approval by supervisors
  - Consider **written** approval requirement
  - Avenues for supervisors to seek approval and ask questions
  - Training re the responsibility
- Perception of fairness is critical
  - But perceptions of double-standards are common

Auditing

- For violations of the policy
  - Review of pre-approval determinations and waivers for consistent application
  - Cross check of employee and vendor data
  - Review T&E receipts for sensitive procurement areas
  - Can also ask third parties for information
    - For example, confirmations that payments have not been made/gifts not given to employees (a variation on the annual holiday letter to suppliers)
Auditing

- For policy implementation
  - Have employees received and signed required certifications?
  - Have employees participated in conflicts training?
  - Have employees completed required disclosures?
- Employee surveys:
  - Awareness of policies, procedures
  - Awareness of internal reporting mechanisms
  - Perception of consistency of application of the policy

Investigating Potential Violations of Conflicts Policy

- Be prepared to investigate following roll-out of disclosure/certifications
- Area of risk for inadvertent violations of privacy
- Independence and authority of investigative function are critical
Discipline for Conflicts Violations

• Deterrence
• Fairness
• Consistency
• Consider perceptions of employees, regulators, and the public
• Commitment to Compliance
  • having high-level review is particularly important
  • responding by adjusting company practices

Gifts and Entertainment

• Rationale
  • Why give gifts and entertainment in the business setting?
  • Global concerns and issues
• Standards for accepting gifts:
  • Dollar limit? (Per gift or per year?)
    • Approval required after specified value?
  • Discussion of acceptable types?
  • Prohibited gifts (e.g., cash)
Gifts and Entertainment

• Standards for accepting gifts:
  • Prohibition against soliciting gifts?
  • Are regional differences permissible?
• Different rules applicable to specific categories of employee?
  • Members of procurement team
  • Members of C&E department, legal department
  • Members of political/lobbying groups

Standards for Entertainment

• Dollar limit? (Per activity, or per year?)
• “Business purpose” requirement?
• Discussion of acceptable types?
• Frequency standards?
• Payment of travel permissible?
• Discuss consumption of alcohol?
Approval Procedures

- Process
  - Who and how of approval
  - Register?
  - Regional guidelines?
  - Resources for questions
  - Resources for reporting concerns
- Controls
  - Appropriately tailored and monitored

Culture as a Foundation for Conflicts Management

- Culture as a foundation for conflicts compliance controls
- Failures can diminish credibility of C&E program
- Apparent conflicts also damaging
- Culture can help overcome
  - Global
  - Practical and
  - Human nature-related barriers
Global Perspectives and Issues

• Privacy
  • Novartis case (2004): French Civil Court ruled that a code constituted an illicit intrusion into the private life of employees.
  • (Loose translation): “While . . . it is common for companies to consider conflicts of interest between work and personal life, it is still necessary that these rules do not constitute a violation of personal privacy.”
  • The court pointed to provisions of the Novartis code that required preapproval for employment and volunteer activities that might constitute a conflict and concerning conflicts involving the activities of family members of employees.

Global Perspectives and Issues

• Variety of views around the world
• Importance of family relationships
  • “In Kenya and other parts of Africa, employees feel they have an obligation to help their family members and their tribal members. They are not trying to take advantage. They are fulfilling their duties.”
  • In some areas, hiring family members seen as a way to increase loyalty to the company.
  • “I hear that in Operations they are all related to each other. It makes it hard to get good information. Relatives are a big problem in our office. Things can go wrong. Also, there can be fighting between the groups.”
Global Perspectives and Issues

• Personhood: Walmart case in Germany
  • The right to determine one’s personhood - including whether and with whom to enter into relationships – is inalienable and may not be interfered with by employers.
  • (Loose translation): “Interfering with an employee’s ability to form relationships at work impacts his or her dignity and has a profound affect on his or personhood.”

Global Perspectives and Issues

• Decreased choices in certain parts of the world
  • “When you are working in certain places, you don’t find too many suppliers from which to purchase. You may have to buy from certain people or drive hundreds of kilometers to a different supplier.”

• Enforcement can be difficult or impossible
  • “It is difficult to tease out suppliers who are related to staff or have other associations. We are foreigners. We often don’t speak the language, and it’s very easy to be misled or duped on these issues.”

• “Preference shaping” role of standards
Behavioral Ethics and Conflicts

- How individuals make decisions when confronted with moral dilemmas – or ethical decision making
- Some important lessons for conflicts analysis and regimes:
  - Bounded ethicality – failure to notice our own or others’ unethical behavior when it is advantageous not to
  - Can we even recognize that a conflict exists?
  - Identifying an issue as involving an ethical dimension makes ethical behavior more likely
  - Self-serving bias – tendency to see the world through our self-serving-colored glasses
  - Controls and approvals/waivers

Behavioral Ethics and Conflicts

- Ethical fading/moral disengagement
- Identification of ethics decreases with self-interest
- Level of morality decreases with self-interest
- Personal interests make it difficult to address situations without bias, even for those of who think we are honest and ethical!