The Board's Essential Role in Compliance and Ethics Programs

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From the Compliance Officer

- "The corporate scandals that have dominated the headlines frequently during the past several years have raised many questions about who was or should have been responsible. Although it has generally been senior executives doing the 'perp walk,' many have questioned the role that boards have played in the ethical collapse."

2

What year?

Daniel Roach, *Journal of Health Care Compliance*, November – December,

2007

3

Do Boards Value Compliance?

- 2018 SCCE Survey “The Relationship between the Board of Directors and the Compliance and Ethics Officer,” noted a possible area of concern is a declining belief that the board is valuing compliance “a great deal.”
- Based on survey data decline from 2014 level of 55% to 2018 level of 40%.
- Right to note concern – but we change things we cannot accept.

4

Today’s Agenda

- Legal Landscape re Boards and Compliance
- Best Practices for Board Engagement
- Missteps and Impediments to Board Engagement
- Practical Tips

5

Legal Landscape

or why do Boards need to “get it” anyway?

6

Why Comply? Don't Cheaters Always Win?

- Employee Retention
- Investor Relations
- Financial Correlation/Stock Price
- Model Ethical Behavior to Employees
- Keeps Competition Fair
- Avoidance of Large Penalties (fines and imprisonment)
- Credit Ratings
- Access to Capital
- It's the Right Thing to Do

7

Stakeholder Expectations

or what is it that the outside world expects?

8

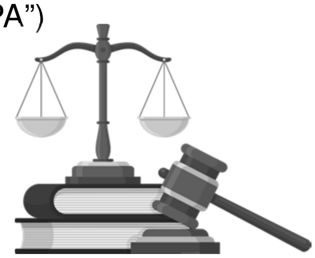
Stakeholders

- Shareholders
- Employees
- Customers
- Vendors
- Community
- Regulators
- Creditors
- Rating agencies

9

Board Involvement: The Law

- *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996)
- *Stone v. Ritter*, 911 A.2d 362 (2006)
- United States Federal Sentencing Guidelines (“FSG”)
- US Statutes, Regulation and Agency Policy. Example:
  – Foreign Corrupt Practice Act (“FCPA”)
  – Other statutes and regulations



10

Caremark

- A Company's Board of Directors can be found to have breached their fiduciary duty and therefore be liable for company losses due to compliance program failures.
  - If they knew or should have known about violations and did nothing to prevent them.
  - If they utterly failed to ensure adequate company systems reasonably designed to prevent a compliance breach.

11

Stone V. Ritter

- Directors can be found to have breached their fiduciary duty and therefore be liable for company losses due to compliance program failures.
  - If facts suggest "a conscious decision to take no action in response to red flags" of wrongdoing within the company.

12

Federal Sentencing Guidelines FSG (Chapter 8)

- A Corporation's culpability score is positively impacted by the existence of an effective compliance and ethics program, to wit a company must, as it relates to its governing body:
  - ensure Board oversight of the compliance program
  - exercise due diligence to exclude unethical individuals from positions of authority
  - communicate information about the compliance program to employees and directors

13

FSG's Board Oversight Directive

"The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."

14

Department of Justice Guidelines

Issued February, 2017

"What compliance expertise has been available on the board of directors? Have the board of directors and/or external auditors held executive or private sessions with the compliance and control functions? What types of information have the board of directors and senior management examined in their exercise of oversight?"

15

U.S. Attorney's Manual

"Do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; ….and have the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. (citing Caremark)"

16

Federal Energy Regulatory Commission

Federal Energy Regulatory Commission's (FERC's) Checklist for an Effective Compliance Program includes:

- Creating an independent compliance officer who reports to the CEO **and the Board**, or a committee thereof
- Providing sufficient funding (**Board** responsibility to the extent it approves budgets)
- Implementing a comprehensive compliance audit program, including the tracking and review of any incidents of non-compliance, with submission of the results to Senior Management **and the Board**

17

Best Practices for Board Engagement

or what's a poor compliance officer to do?

18

How do you grow from a reporting function to a foundational, strategic asset?

- Compliance Officer should at least be a dotted line report to the Board or Board Committee.
- Beyond just a passing tip of the hat to “tone at the top.” In order to establish “tone at the top,” the Board must be engaged on compliance matters.

19

How do you grow from a reporting function to a foundational, strategic asset?

- Deep engagement requires TRAINING
  - Training should be done by the Compliance Officer
  - Training should focus on
    - The Board’s role in Compliance
    - Conflicts of interest
    - Overall regulatory/government expectations
    - In highly regulated industries such as energy, specific issues, such as FERC’s expectations, market manipulations rules, etc.

20

How do you grow from a reporting function to a foundational, strategic asset?

- But there is more; training should also focus on the basic foundations of the compliance program:
  - The reporting system
  - The communication plan
  - The compliance committee
  - The metrics used to measure an effective program
  - The short-, mid- and long-term plan for compliance in the organization
  - Risk assessments and the interplay with enterprise risk management
- Board members should attest to the training

21

How do you grow from a reporting function to a foundational, strategic asset?

- Benchmark your program to other similarly situated companies.
  - AND SHARE THE RESULTS WITH THE BOARD
- Evaluate the compliance culture of your organization through employee engagement surveys.
- Conduct a compliance program assessment overseen by and with Board or Board committee participation.
- Prepare an annual compliance report.
- Tie compliance metrics to executive compensation/ clawback policy.
- ASK THE BOARD WHAT MORE THEY WANT OR NEED FROM YOU.

22

What should a well-trained director know?

- What are the fundamental elements of the company's compliance program and how do they inter-connect? Does it extend beyond the company to include vendors, service providers and partners?
- How does the Board actually oversee the compliance program? Via Board committee? The full Board? Other? How often does it receive reports? From whom? Why was this structure chosen?
- Who is the CCEO? What are his/her credentials, how was he/she selected and how is he/she evaluated? What are the CCEO's lines of reporting and how are his/her base compensation and incentives structured and why?

23

What should a well-trained director know?

- What other personnel have compliance responsibilities, how do they report, how do they connect to the CCEO?
- What resources are available to the CCEO? What is the annual compliance budget and how does that compare to peer companies? Are the company's compliance resources sufficient, taking into account all relevant factors?
- How does the compliance program reflect the company's risk priorities and tolerances? How does it adjust to reflect changes?

24

What should a well-trained director know?

- How and how often do company personnel receive compliance training? How is their compliance knowledge and performance measured? How is compliance enforced?
- What role does senior management play in the compliance program?
- To what extent and how does the company engage independent professionals to evaluate the company's compliance program?
- What are the compliance program's strengths and weaknesses?

25

Missteps and Impediments

or what's a poor compliance officer to do?

26

Common Pitfalls

- Failing to start with a risk assessment. You cannot create a program without knowing your compliance risks.
- Failing to right-size your program.   A program that is too big for your small organization or too small for your big organization will lose your Board.
- Practice and train in public speaking. If you drone on and on and on with your Board, you've lost.

27

Common Pitfalls

- Thinking you can limit a compliance program, say to simply FERC matters, for example.
- Allowing the Board to control the dialogue. (Not the oversight).
- Appearing evasive or less than fully honest or open.
- Thinking a program is a risk assessment.
- Not following through on promises made to your Board; if they seek more information, provide it.
- Complacency.
- Losing the trees for the forest; your Board must be engaged but do not lose your focus on your employees.

28

Practical Tips

or, can we talk?

29