

Risk Management: Controlling Compliance-Associated Risk

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Editor's note: This is the final article in a three-part series on risk management. Earlier articles focused on identifying risk and transferring risk through insurance.

Regulatory compliance is one of the biggest challenges for companies today and has become its own industry. A Google search of "regulatory compliance" returns more than 39 million hits in less than a second, and it's not hard to find people who believe that this has become the biggest risk issue for companies. It is easy to understand why. Even before the financial crisis, the number of statutes and regulations in effect was staggering. With heightened focus on the financial sector, new oversight bodies and ever-increasing reporting requirements, considerable effort is required just to understand what regulations apply to your company, let alone to actually comply with them. The good news is that complying with your regulatory obligations presents a risk area that is readily susceptible to control. In many ways, regulatory compliance is a microcosm of risk management itself: identifying applicable regulations, developing and evaluating compliance methods, cost-benefit analysis of what approach best fits your needs and goals, and regular review and modification as necessary.

It is important to start with a big-picture look at all of the different regulations that impact your company. The obvious starting points are regulatory schemes of general applicability, such as tax, labor and employment, and environmental provisions and industry-specific regulations that apply to your business. Next, it is important to look at the regulatory schemes that pertain to your customers and vendors, if different from your own, to make sure that you are not subject to any additional requirements that might not be readily apparent. It is also important to keep an eye out for regulatory enforcement proceedings involving your industry.

There are two main pieces to a successful compliance program. The first is having in place the structure and systems that make compliance activities a routine part of operations. Whether that is filing quarterly and annual reports, periodic testing of waste and discharge, or inspecting a finished product, compliance activities should be part of routine procedure in your company. This includes training for employees, whether they be new hires or existing employees, as part of adopting a more comprehensive risk management plan. Particularly with regular reporting requirements, much of a compliance system can be handled through software or can otherwise be automated. Many companies specialize in or have segments of their business devoted to regulatory compliance issues. Industry and trade associations are another source of guidance and support in addressing compliance issues. Given that these are legal requirements, you will want to have the system that you develop reviewed by an attorney to ensure that it will keep you compliant.

The second main component is oversight and review—both of the systems in place and ongoing developments in regulations. This is the part that is easy to overlook or to allow to lapse. It requires discipline to stay on top of compliance issues. Simply setting up a system is not sufficient. Not only must it be followed, but it can also lead to a false sense of security that everything is OK. As part of the oversight and review process, there should be a method for soliciting input from those employees who are doing the legwork to find out what is or is not working and suggestions for improving the compliance process. This likely sounds like common sense or even the same old advice that everyone gives. Remember that it is human nature to become complacent or bored with routine tasks. This reality impacts businesses large and small every day, and there is no worse way for it to materialize than in the middle of an enforcement proceeding, regulatory review or litigation. It is also important to keep abreast of regulatory developments that impact your business. Monitoring the rulemaking activities of any agencies with direct regulatory control over your business or operations will keep you on top of changes that could impact such business decisions as how or when to upgrade a plant or other facility. It also allows you the opportunity to meaningfully weigh in when those agencies solicit public comment on proposed new rules. Being in command of your compliance situation will enable you to readily provide data and examples that can help soften the impact of new requirements or even lead to common-sense exceptions.

That is not to suggest that a sound regulatory compliance system is a shield or cure against violations. Mistakes will happen. But a vigorous system will identify issues early in the process. Numerous environmental provisions dealing with discharges to air and water constitute ongoing violations, such that penalties are assessed on a daily and even hourly basis. Generally speaking, penalties are much less severe when the company identifies, corrects and reports the event to the applicable regulatory authority rather than having the authority investigate a complaint or issue. A properly designed and operating compliance system will allow you to respond to events in a timely manner. It will also prevent latent and festering compliance issues from becoming all-out infernos. It can also greatly reduce the risk of whistleblower lawsuits. One of the more common litigation concerns for companies is disgruntled or former employees. Disorganized or indifferent approaches to regulatory compliance simply provide fuel for disgruntled employees and even competitors to use against you.

No one likes to be sued, but for successful companies it is a fact of life. Whether it is a disgruntled employee trying to cash in, a competitor playing tough, someone simply looking for deep pockets, or the result of an accident or legitimate difference of opinion with a vendor, litigation will arise. Proper compliance with regulatory requirements can prevent certain types of litigation and drastically reduce the likelihood of an adverse outcome. But beyond that, it empowers you with the knowledge and resources to evaluate a claim quickly at the outset so that it can be dealt with properly. There are also those situations where you may wish to pursue litigation to vindicate your own rights. Either way, you will be in a better position if you have a strong compliance system in place that includes a sound document management system. Many regulations have record-keeping requirements, but it is important to also consider the parameters of electronic discovery when designing your document system.

Electronic discovery is a fact of life in both litigation and arbitration today. Largely gone are the days when the files are simply in filing cabinets or a few boxes in storage. Electronic discovery can be both costly and time-consuming, especially when there is no system in place for dealing with such requests. Electronic files are here, there and everywhere. Desktops, laptops, smartphones, tablets and servers can all house copies or versions of the same document. Under federal and state discovery rules, all copies or versions of that document are potentially discoverable. Collecting, sorting, screening and producing documents can be a daunting task. In even fairly routine commercial litigation involving five to seven people on either side and a relevant timeframe of 18 to 24 months there can be millions of emails. Throw in attachments and the number of documents jumps even higher. Then there is the time and cost for review.

But when you have invested in a comprehensive risk management system to address regulatory compliance combined with an integrated document management system, you will be in a good position to deal with litigation or enforcement proceedings. Why? Because you will be able to tell in short order whether or not there is any merit to the claim—and, if you have been diligent in ensuring regulatory compliance, the answer should be no. You will know where to look for records and what employees to talk to because it will all be organized ahead of time.

How quickly and effectively can you implement a litigation hold? The answer in many instances should be quite short during normal business hours. There should be a designated person or team depending on the size of your organization in the IT department who simply needs to know the names of the employees covered by the hold and should be able to quickly freeze their accounts and any relevant folders or other electronic repositories to prevent the deletion of files.

Imagine how much more confident you will be heading into your next piece of litigation knowing at the outset what is involved in terms of document discovery. You will be in a position to control the posture and pace of the litigation from the outset. While the level of sophistication that is involved in compliance efforts will obviously vary by company, this is an area that can and should be managed carefully to put and keep your organization in the best position to succeed. Your attorney as counselor is a valuable resource in that effort.

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