



Michael C. Ross

# Get Ready, Set, Comply

By Michael C. Ross

In the wake of Enron, WorldCom, Health South and other notorious corporate scandals, and with the implementation of Sarbanes-Oxley, more than a few general counsel are likely feeling overwhelmed by all the resources being allocated to compliance and governance programs.

It is difficult, not to mention very politically incorrect, to argue that legislative and regulatory reforms have been excessive or unnecessary. Government agencies, media, plaintiffs' counsel, investors and governance-rating firms are all shining a spotlight on governance and compliance. It should come as no surprise that there isn't anything particularly newsworthy about companies with longstanding records of solid governance, ethical business conduct and effective compliance programs – unless, of course, they suddenly become the focus of yet another corporate scandal.

Abandoning the governance/compliance playing field is not an option. However, there may be some room for general counsel and their compliance departments to manage these efforts effectively and efficiently. Rather than addressing any of the technical requirements of Sarbanes-Oxley or any other laws or regulations, the purpose of this article is to suggest some general ideas for the implementation and enhancement of compliance programs. Although implementation requires substantial effort, once truly effective programs are implemented, they should reduce not only the internal and external costs of noncompliance but also the resources devoted to compliance programs.

## Risk Assessment and Priorities

Corporate codes of business conduct and compliance programs must cover a wide variety of subjects, from securities laws, employment practices and vendor and customer relations, to environmental laws, antitrust statutes and workplace violence, to name just a few. Efforts to perfect all these programs at once can be overwhelming. A sensible beginning point is an

assessment of risks and their priorities. That is, how likely are the risks to occur and how severe are the consequences of occurrence? Although each risk has its importance, resources are limited. There is, after all, only so much time and money that can be diverted from running the business. All compliance and no business make a company's investors unhappy.

It takes discipline and thorough, careful analysis to make judgments about which risks deserve the highest priorities. But the exercise is very valuable. It demonstrates realism and rationality. Hackneyed though it is, the old adage that "Rome was not built in a day" most definitely applies here. Success with high-priority programs will generate momentum and provide valuable lessons for lower-priority programs. While lower-priority programs cannot be ignored, they may proceed at a somewhat slower pace than high-priority programs.

## Management Support

Compliance programs will have little benefit without management's full buy-in. It has become trite to say that leadership of senior management is critical to the success of compliance programs. There is, of course, no substitute for leadership by example from the top down. What goes unsaid and unexplained, however, is how to motivate business people to devote resources in a timely manner to compliance programs. History has shown that the negative incentives of sentencing guidelines and the dicta in a seminal 1996 Delaware Chancery Court ruling that involved Caremark International Inc. have not been sufficient motivations. (Readers may recall Delaware Chancellor William Allen's admonition in his Caremark opinion that a board of directors must have a reasonable basis for concluding that a particular company has adequately assessed its risk and put in place effective programs to address those risks.)

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Very few companies have emphasized positive incentives in order to achieve compliance. In many cases, an effective compliance program can increase the bottom line, for example, through lower product costs, better inventory management and improved employee productivity. Compensation criteria for managers rarely include factors that try to measure effectiveness in promoting business ethics and compliance. These incentives are likely to be more powerful than liability and publicity avoidance when it comes to getting management's attention.

### **Employee Communications**

Effective and efficient compliance programs should be more than sets of rules, regulations and admonitions. Written acknowledgements by employees have become commonplace, particularly with the implementation of certifications pursuant to Sarbanes-Oxley. But even employees who have signed on the dotted line break the rules.

Employees are more likely to comply if they are given good reasons for the rules, and explanations about why the rules are good for the company and for them personally. Clarity of the rules, examples of compliance and noncompliance, and meaningful opportunities to ask questions are less common but should all be part of any effective program. Employees should understand how the rules support the principles for which the company stands. Certainty of consequences for failing to comply, demonstrated by an enforcement track record, is a must. Newsletters and other periodic communications can reinforce the message by relating stories (probably without naming names) of noncompliance and good compliance.

### **Board of Directors/Audit Committee**

Managers are not the only ones reeling from all the governance and

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compliance attention. Several company directors who attended Stanford Law School's Directors' College this past June expressed frustration about the amount of time and attention devoted to governance and compliance. For the most part, these are men and women who have joined and remained on boards of public companies because they enjoy business, are challenged by strategic and long-term planning, and want to contribute some of their own business experience to various endeavors. The challenge for general counsel and their compliance departments is to assist the board and audit committees (where much of the burden has fallen) in developing efficient but effective procedures for assessing risk and assuring the effectiveness of compliance programs.

Directors should not be expected to deal with all the details. That is not the best use of their time or their talent. It has, therefore, become more important than ever that general counsel and compliance officers exercise astute judgment in assisting directors in fulfilling their fiduciary duties.

Some companies, particularly those that have suffered mismanagement, or worse, will need to devote more attention and resources than others when it comes to their compliance programs and business ethics. All companies, however, share a strong interest in implementing and operating effective and efficient compliance programs.

At the end of the day, investors care most about financial performance. It is sometimes useful to keep in mind that all these programs are tools for helping management achieve financial success and create real shareholder value. Credit for doing things right will undoubtedly be reflected in the company's share price. ♦

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