

## Corporate Compliance and Ethics Programs

### *Beware and Be Smart*

#### *1. What is Corporate Governance?*

*Corporate governance* refers to the manner in which a corporation is directed, and laws and customs affecting that direction. It includes the laws governing the formation of firms, the bylaws established by the firm itself, and the structure of the firm. A company's corporate governance refers to the relations, distribution of rights and responsibilities by and among primarily four groups of participants; i.e., the board of directors, managers, employees and shareholders.

The governance of a corporation includes the rules and procedures for making decisions and provides the structure through which the company objectives are established, the means by which stated goals are achieved, and the monitoring of the performance of those objectives.

In short, the corporate governance system of an organization is the structure by which a company's directors and managers act in the interests of the firm and its shareholders and employees and how the company aspires to holding the board, managers and employees accountable to capital providers and third parties relying upon the value of its assets. Issues of fiduciary duty and accountability are often discussed within the framework of corporate governance.

#### *2. Corporate governance standards have changed*

The public scandals of Enron, Tyco and WorldCom have resulted in a regulatory and investigative response unlike any other in history. The passage of Sarbanes-Oxley Act of 2002 (SOX) is

more sweeping than any other legislation since the New Deal. Board rooms and corporate offices now have handbooks addressing governance and compliance; however, without an effective implementation plan the policies are meaningless and will not change the culture of an organization. The regulatory activities of the SEC and other governmental bodies have resulted in a mandate to board members and executives of public and private companies to implement comprehensive and effective corporate compliance and ethics programs. The establishment and implementation of an effective compliance and ethics program will assist the organization in several meaningful ways in that it will:

- establish a corporate culture of integrity and fair dealing
- improve the understanding ethical obligations
- serve as a basis for a crisis management plan that identifies and addresses compliance and ethics problems before they become an issue.

Compliance programs are not static and they do not solve all problems. Communication and training are the key ingredients to successfully changing the culture in an organization. Recognizing issues as they arise rather than after the investigation has commenced is the key to a successful program.

### *3. What are the elements?*

The requirements of an effective compliance program extend beyond the mere adoption of policies and procedures. Codes of ethics, codes of business conduct, internal controls and the coordination of technology are basic requirements under SOX and although considered an integral part of the new era of corporate governance, all business organizations should be taking a broader view of how to implement an effective compliance program and institute meaningful corporate governance reform using SOX and guidelines from the Federal Sentencing Commission as a road map.

The Sentencing Commission and Office of Inspector General have published guidelines for an "effective" compliance and ethics program which has become the standard by which most corporate compliance and ethics programs have been assessed. The Department of Justice has adopted a formal policy requiring all federal prosecutors to take into account whether or not a company has an effective compliance and ethics program in making the decision whether or not to charge a company with a criminal violation. Effective compliance and ethics programs integrate diverse aspects of a company's business, legal and regulatory environment. A dedicated process of implementing SOX type changes will ordinarily result in positive cultural changes in the organization which are essential to create a successful corporate environment.

### *4. Officers and Directors take notice*

Recent developments in Delaware corporate law place a greater emphasis on director and officer involvement. Oversight is not a rubber stamp of management decisions. The landmark case in this area is Delaware Chancery Court decision in *In re Caremark International Inc.* in which the court held that directors cannot merely rely on the good faith of corporate employees and may be held liable for failing to ensure that appropriate information and reporting systems are in place. The responsibility of the officer and director now extends to an affirmative duty to ensure that a corporate compliance system exists and that the absence of such a system may render directors liable for any losses caused by non-compliance with legal rules and regulations.

The importance of compliance programs in today's business environment is also underscored by statements in the American Bar Association's Model Business Corporation Act. In evaluating the director's duty of care it is recognized that compliance programs are an important tool in fulfilling the oversight responsibility of a board member. The guidelines described by the ABA recommend that a director's role in the affairs of the company include the establishment and implementation of policies that will comply with applicable law. The focus for directors and officers should be on that which brings the company into compliance and how to secure director and officer liability insurance and charter and/or by-law indemnification.

### *5. Is it possible to be cost effective in developing and implementing an effective compliance program?*

Coordination between general counsel and outside counsel regarding compliance and ethics programs is essential as it relates to reporting responsibilities. The corporate scandals cited demonstrate that failures in compliance may disrupt an organization's business operations, harm its reputation and result in fines, legal fees, prison terms or all of the above. Developing a crisis management plan that incorporates governance principles and a compliance program is more cost-effective to an organization than reacting to an investigation without having done so in advance. Shielding the enterprise and its directors and officers from potential liability is not a guarantee; however, this goal is only possible if a well devised compliance program is in existence to assist the organization in detecting or preventing wrongdoing at an early stage.

*This update is a summary for general information and discussion only. It is not a complete analysis and may not be relied upon as legal advice. Please contact Gary R. Pannone, Esquire for further consultation at 401-824-5115 or send an email to him at [gpannone@pld-law.com](mailto:gpannone@pld-law.com).*