Energy Sector Alert Series: Modern Compliance Programs in an Age of New Threats

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In this eight-week alert series, we are providing a broad look at current and emerging issues facing the energy sector. Attorneys from across the firm will discuss issues ranging from environmental disclosures and risk management in business transactions to insolvency, compliance programs and intellectual property. Please click here to read all of our recent publications.

Companies operating in the energy space face a host of new compliance obligations and challenges, ranging from data privacy to new regulations to physical security. While many federal agencies have a policy or set of guidelines addressing their expectations for a compliance program, reliance solely on agency guidance is often inadequate. This is particularly true for large companies that operate in multiple jurisdictions and across sectors. Many of the emerging threats facing the energy industry were not envisioned by agency regulations or guidance, which are typically static and offer little real-world guidance for practical application. Building a company's compliance program solely around the components laid out in agency guidance can lead to a false sense of security and leave the company vulnerable to complacency and exposed to new threats.

Every company is different, and each corner of the energy industry has different specific compliance obligations. But our experience assisting companies in developing best-in-class compliance programs indicates that certain fundamental tenets apply to virtually every context:

- A compliance *system* that works together is critical. Developing the right components is important, but the best programs are designed to communicate information and provide multiple lines of defense.

- Policies and procedures are just a start. It is critical to *follow* your own procedures; failure to do so leaves you vulnerable to an accident or violation, and exposed in the litigation that inevitably follows.

- Compliance systems must be *dynamic*. There are always new threats and new obligations —the best compliance programs are in a constant state of evaluation, assessment and continuous improvement.

Beyond these principles, the following outlines what we have found to be the building blocks of the best compliance programs.

Developing and Implementing a Compliance System

There are two simple reasons for a robust compliance system: avoiding accidents and violations in the first place, and, if your company does have an accident or violation, securing a comparatively lower penalty.[1] Federal agency penalty policies and guidelines often provide a list of the specific characteristics of an effective compliance program. Having those components in place is an important start, as FERC and other agencies still provide "credit" for having an effective compliance program in place when assessing penalties,[2] or deny such credit if the compliance program is found to be lacking.[3]

But agency guidelines typically offer little more than a list of components. Practical industry experience is imperative—whether issued by FERC, DOJ or EPA, no list of components is precisely tailored to a single industry, much less your company.[4] Moreover, having a compliance program in name only can prove worse than having nothing—one of the first questions a plaintiff's attorney will ask after an accident is whether a company followed its own standards. The trick is building a program that has every component expected by regulators, but goes beyond "checking the box" and is instead a dynamic, integral part of your company.

Focus on the basics. The most important building blocks of your compliance system are your people. There is nothing more important than hiring the right employees, making sure they understand their compliance-related obligations, and providing clear and continuous training.

Recruiting and employee evaluation. A culture of compliance starts and stops with your company's employees. Background checks for all employees, including criminal history and employment history for the preceding five years, are typically a baseline. For positions with important compliance obligations, consideration of a potential employee's commitment to ethical conduct and compliance history (internally or externally) should be measured in the hiring process.[5] All employees should be evaluated on the basis of their ethical and compliant conduct and against the competencies defined for their specific roles. It is important that a company maintains records reflecting that it conducted this review in making its hiring and promotion decisions.

Defining roles and responsibilities. Compliance-related roles, responsibilities and authority should be clearly defined throughout the company. Ideally, the company would have a manual or matrix describing its principal compliance requirements and making clear who has primary compliance responsibility and who has oversight and/or monitoring responsibility. At a minimum, the compliance-related responsibilities for each position should be reduced to writing in order to avoid the common problem of knowledge leaving with an employee who exits the company or a particular position.

Training. A compliance system can only be effective if it is understood by employees. Compliance training is one of the biggest challenges at a company—it is of critical importance, but it is difficult to present in a real-world, practical manner that resonates with employees. The degree and type of

appropriate compliance-related training will necessarily vary according to an employee's role, but every employee should at least be trained annually on a company's compliance system itself, which should in turn emphasize the areas of specific significance to that employee's role. In general, compliance training should be as concrete and tailored to real-world situations encountered by each employee as possible. The training completed by each employee should be tracked and monitored, typically by the human resources department

Contractor management. Many companies operating in the energy space rely significantly on the services of contractors. One of the toughest challenges facing a company is ensuring that their contractors adhere to the company's high standards for compliance, often including following your company's policies and procedures, but still accept responsibility for their own actions. Identifying contractors with the best compliance record requires significant due diligence; this can include interviews, marketplace intelligence, reviewing publicly available debarment and sanctions lists, and requiring prospective contractors to complete a compliance questionnaire, with a senior officer from the prospective contractor certifying the accuracy of its response.

Build a culture of compliance. Governmental policies, industry standards and academic research confirm that both a strong corporate ethics and compliance culture and robust compliance controls are necessary in order to have an effective corporate compliance program.[6] These are the "soft" factors of compliance—arguably the most important, and most difficult, to get right

Engagement from the board of directors. The board of directors and senior management play a critical role in setting the "tone at the top" and providing the sustained leadership and support needed for implementation of a successful compliance program.[7] The executive leadership team as a whole should be accountable for guiding and supporting a compliance system, and should be knowledgeable about the company's most important compliance risks. To that end, we have seen considerable success when companies establish a high-ranking compliance role that reports to the CEO, the board of directors, or both (an approach some government enforcement policies encourage).[8]

Board actions made in connection with oversight of your company's compliance program should be documented in readily available fashion, with the goal of being able to easily point to the board's active involvement in compliance issues. Here, the objective is not to micromanage the decisions of the company's compliance experts, but instead to ensure the board is aware of and engaged with the compliance program.

Leading from the middle. While the top of the company sets the tone, most employees' day-to-day access is limited to mid-level managers. In some ways, it is therefore at least as important to set the right "tone from the middle." Mid-level managers must communicate and model the company's ethics and compliance values in order to embed the values throughout the organization.[9]

Develop a corporate compliance policy—then live by it. A formal corporate policy on compliance serves as the philosophical foundation of the compliance program. The policy should articulate the company's commitment to full compliance and describe the expectations of leaders, managers and line employees relating to compliance. But the policy cannot be empty words. Management should

know the policy, and should live it. When asked, employees should know the company has such a policy, should generally know what it says, and should internalize its high expectations.

Communications. Ethics and compliance values and objectives should be incorporated into messaging from company leadership at all levels in order to make clear their personal commitment to these values. Information on ethics- and compliance-related policies and procedures should be readily accessible to all employees. At a minimum, the company should have written guidance that provides for elevation of repeat issues that create compliance risk or concern.

Planning and budgeting. Full compliance with all legal requirements and company policies should be treated as a strategic goal, and the resources devoted to this effort should reflect the company's commitment. An underfunded compliance program has little chance of success, and is a ready target for government enforcement and private litigants.

Documentation is important, but action and behavior are paramount. Government enforcement authorities—as well as private litigants—often focus on a corporate defendant's compliance with its own policies in seeking to establish liability for penalties or damages in cases involving industrial accidents, environmental contamination and other compliance-related proceedings. It is therefore critical to adhere to your own compliance policies, and to keep excellent documentation of your compliance-related efforts.

Policies, standards and procedures. A standardized approach in which companies establish enterprise-wide compliance policies, standards and procedures helps ensure reasonable consistency across the company in terms of the content of these requirements, as well as the process for implementing them and training on these policies. There should be a standardized process by which the company rescinds internal policies and procedures that are out of date or are no longer in use. If an accident or other compliance-related incident occurs in one part of the company that has less stringent standards or practices than another part, or it is simply failing to follow its own procedures, the company has real litigation and enforcement exposure.

Records management. Many energy companies are subject to robust recordkeeping regulations, particularly public utilities. We encourage the development of company-wide records-keeping policies and a well-trained staff devoted to this issue to ensure its success.

Management of change. Accidents and compliance violations often follow periods of structural change at a company or the implementation of new procedures. It is often prudent to implement a company-wide standard for identifying, evaluating and managing the compliance risks potentially arising from significant changes to facilities, equipment, technology, work processes, regulatory requirements, staffing and organizational structure.

Regular risk assessments. Regulatory obligations change, as do risks. Companies therefore must periodically assess both their compliance program and emerging threats. Whether this takes the form of formal auditing or some other type of monitoring depends on the company's size, structure and industry, but the objective is the same—the company is following its own compliance program, and is successful in avoiding compliance violations and accidents. For large, complex compliance programs, periodic assessments by outside compliance experts can lend helpful independent and

objective perspectives.

Assessments should include thoughtful analysis of any accidents or near misses at the company, and any regulatory violations. There should be a consistent threshold for when an investigation is initiated, a uniform set of investigative techniques, and a standard approach for classifying the severity of incidents. A thorough assessment can also extend to evaluation of customer complaints, employee tip-line grievances, notices of violations, and compliance-related interviews with employees in key positions, such as audit, legal and human resources.

There has been more focus, and more stress, on companies' compliance systems as new threats and regulatory obligations have emerged in recent years, particularly in the energy space. Companies rightfully look to agency guidance for the requisite components of their compliance systems, but industry leaders go beyond these building blocks to develop dynamic compliance programs that are integrated into the heart of the company.

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[1] *See, e.g.*, Federal Energy Regulatory Commission, *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156 (May 15, 2008), ("FERC Enforcement Policy"); Federal Sentencing Guidelines § 8B2.1(a) (addressing the sentencing of organizations, including the positive sentencing implications of having an effective compliance and ethics program that prevents and detects criminal conduct).

[2] *See California Independent System Operator Corp.*, 149 FERC 61,189 (2014) (explaining that CAISO received credit for, among other things, having an effective compliance program).

[3] *See BP America, Inc.*, 152 FERC 63,016 (2015) (finding among other deficiencies that BP lacked internal standards to prevent and detect violations and inadequately reviewed its compliance program).

[4] Independent standards setting organizations likewise have their own compliance standards. See, e.g., ISO 55001 and PAS-55 for asset management; ISO 14001 for environmental management; and API RP 1173 (draft) for pipeline safety management.

[5] The Sentencing Guidelines call on organizations to use "reasonable efforts" to avoid placing into positions of "substantial authority" any individual who the organization knew, or should have known through the "exercise of due diligence," had engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program. Federal Sentencing Guidelines, § 8B2.1(b)(3).

[6] *See, e.g.*, ISO 19600, *Compliance Management Systems – Guidelines* (2014), at v ("Compliance is an outcome of an organization meeting its obligations, and is made sustainable by embedding it in the culture of the organization and in the behavior and attitude of people working for it."); Federal Sentencing Guidelines, § 8B2.1(a) ("To have an effective compliance and ethics program … an Organization shall … promote an organizational culture that encourages ethical conduct and a commitment to compliance with law."); Federal Energy Regulatory Commission, *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156, at ¶ 59 (May 15, 2008), ("FERC Enforcement

Policy") (providing suggestions for how companies can build "a strong compliance culture" to support compliance programs); Blake E. Ashforth et al., *Re-Viewing Organizational Corruption*, 33 ACAD. MGMT. REV. 670, 677 (2008) ("[O]rganization-level research has shown that the optimal approach [to ethics and compliance management] emphasizes aspirations and values backed by accountability to laws and regulations.").

[7] *See, e.g.*, Federal Sentencing Guidelines § 8B2.1(b)(2)(B) ("High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program."); Federal Energy Regulatory Commission, *Policy Statement on Compliance*, 125 FERC ¶ 61,058, at ¶ 13 ("Developing a strong continuing culture of compliance is a critical task for every company subject to our statutes, regulations, and orders, and the responsibility for a culture of compliance rests squarely on the shoulders of senior management."); U.S. Dept. of Justice (Criminal Division) & U.S. Securities and Exchange Commission (Enforcement Division), *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, at 57 ("Within a business organization, compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company. Managers and employees take their cues from these corporate leaders. Thus, DOJ and SEC consider the commitment of corporate leaders to a 'culture of compliance' and look to see if this high-level commitment is also reinforced and implemented by middle managers and employees at all levels of a business.").

[8] *See* Federal Energy Regulatory Commission, *Policy Statement on Enforcement*, at 10 (Oct. 20, 2005) (enumerating factors reflecting a company's commitment to compliance, including whether the compliance program is "supervised by an officer or other high-ranking official" and the extent to which the "compliance official report[s] to or ha[s] independent access to the chief executive officer and/or the board of directors"); *see also* Federal Sentencing Guidelines § 8B2.1(b)(2)(B) & (C) (high-level personnel of the organization shall ensure implementation of an effective compliance program and have "direct access" to the governing authority).

[9] The National Business Ethics Survey reports that when executives and supervisors "emphasize ethics, keep promises, and model ethical conduct, misconduct is much lower than when employees perceive that the 'ethics walk' is not consistent with the 'ethics talk'." Michael E. Brown & Linda K. Trevino, *Managing to Be Ethical: Debunking Five Business Ethics Myths*, 18(2) ACAD. OF MGMT. EXEC. 69-81, 73 (2004).