

**Integration and Culture-The Linchpins for Corporate Success and Governance
in a Scary World**

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Integration and Culture

A company's success in the environment, safety, health and process safety/risk management (EHS) area must be measured by not only achieving compliance with environment and safety laws, but sustainability. Many companies claim they are or are actually trying to transform the way they do business, including creating a sustainable "best in class" culture. Achieving the same result in the EHS area will require more than a "cookie cutter" approach, adopting some "magic formulas," or a compartmentalized, engineering solution. It will require the integration of new and refined management systems and supporting accountability metrics into the company culture. This is particularly important in the light of the new federal Sentencing Guidelines and Sarbanes-Oxley, discussed subsequently.

An EHS management system cannot be developed in a vacuum and needs to have solid operational management systems as a base. This is the foundation assumption of U.S. EPA's Performance Track and the Global Environmental Management Initiative (GEMI) Self Assessment Program, as well as the OSHA Voluntary Protection Program (VPP). Management systems also need to be transparent and help develop and sustain a culture that creates a systematic approach to doing business seamlessly and effectively, day to day.

While there are certain core elements -- the "basics" -- that are generally associated with an effective EHS program, the cultural issues are particularly critical in the EHS context. "Culture" in the EHS context, means the collective attitude and behavior of a company's employees, particularly as they relate to environmental protection and safety on the job. More than any other single factor, the culture has a determinative effect on how well an enterprise operates. There is simply no substitute for an acute collective awareness of what constitutes appropriate environmental protection, safe behavior and a collective intolerance for environmentally unsound practices and unsafe behavior. I suggest that the most critical factor required for a company's success in the EHS area is a positive EHS and process safety culture. As one client described the successful integration of these functions into the culture-"We just do it."

In the environmental context, the GEMI Self Assessment Program, designed by managers for managers, clearly defines the integration of the environmental function as follows:

“Level 3-Integration into General Business Functions”¹

The company has formal systems to **integrate environmental management concerns into its management functions** and general business conduct on a regular basis. Environmental information and concerns are thus incorporated into all relevant business planning functions, including corporate policies, capital budgets, product design, development, manufacture and disposition and marketing strategies, hiring decisions, implementation programs and reporting. The environmental concerns include direct and indirect environmental impacts of products, operations and services, extending beyond maintaining regulatory compliance.” (Emphasis in original)

Management of environmental issues should take advantage of broad experience in operations, management systems and the interrelations of environment, health and safety to management culture to examine a company’s approach to EHS in the context of broader management issues. Accordingly, in reviewing the adequacy of an EMS, many times my own recommendations discuss broader management issues and opportunities, which are tied to the EHS issues that were identified as part of the review. The implementation of these recommendations, with an experienced eye on achieving effective integration within the enterprise’s organization and business processes, is also critical for EHS performance success and sustainability. The broader understanding of management issues and opportunities also ties to the federal Sentencing Guidelines and Sarbanes-Oxley, as discussed subsequently.

Similarly, a critical path toward integration of EHS into the culture and as part of “we just do it” is adopting a process safety or “risk based” management approach. This is an important and in many cases the primary proposed strategy for implementing management recommendations.

For example, many facilities and managers assume that “management of change” applies primarily to specific process change and applicable OSHA work place safety regulations. However, “change” can have much broader and more significant implications and impact on the business. It can affect quality and general operations, not just process safety. Data management systems manage change, as do quality systems. Productivity is also impacted and means to improve productivity such as standardizing operating procedures, or establishing basic employee skill requirements such as computer literacy, can act as significant change agents.

¹ Level 4 is “Total Quality Approach,” which assumes an integrated system applied globally and continuously evaluated for improvement.

In general, both as a matter of process safety and as a general manufacturing process, it is important that all the significant implications of “change,” even a seemingly limited change in a manufacturing process, be identified, carefully evaluated, appropriately acted upon and documented as part of a formalized Management of Change (MOC) process. This is not always the case. Specific and detailed procedures should be established for any change and that change must be clearly documented. For example, Piping and Instrumentation Drawings (P&IDs) in many facilities are very poor. Documentation of electrical work and engineering for new equipment may be better, but is often lacking in older equipment or older portions of a facility. This lack of documentation impacts production, process safety and in some cases personnel safety and environmental compliance. Many environmental incidences and permit issues are a result of failure to adequately manage change.

Process Safety Management (PSM) is broader than the OSHA work place regulations. While some company processes and facilities are directly subject to the OSHA regulations (although not to the PSM regulations), I define the concepts more broadly than regulatory compliance. The concept here is goal setting and performing “through” normal compliance requirements to establish a high performance culture that effectively “manages” overall EHS risk. Establishing such a process safety/risk management culture is vital to “best in class” management. An incident can hurt an individual, create environmental damage and destroy valuable equipment, all of which negatively impact customers, the community and the overall company. Thus, a process safety/risk management culture improves not only process safety, but also personnel safety and environmental controls. It avoids “stove piping”- looking only at environment or looking only at safety considerations, without examining the broader interrelationship of these functions, as well as their significance in operations. Preventive/predictive maintenance, data management and incident investigation are part of PSM. This management concept ties the EHS functions together and in turn integrates them into general management as part of the culture, achieving “we just do it.”

Development of such a “risk based” culture will provide the sustainability necessary to assure that EHS is fully integrated into the company management culture. Most significantly, the institution of the risk based culture will provide the base for any systematic approach to EHS management that will work best with the changing goals of the company, assure compliance and allow a systematic approach to EHS to become the readily accepted way of doing business. In essence, this approach is an operations and overall business inclusive approach to achieving the targeted EHS objectives.

Culture and Compliance

While these previously discussed concepts make good business sense, they are particularly important in today’s new compliance based pressures. Effective environmental management systems (EMS) are the most cost-effective ways of doing business and achieve cost savings on labor, energy and material resources, improving

financial performance while lowering the risk of costly administrative, civil or even criminal liability. ²As I have stated many times, if you have a management system designed strictly for compliance, it is a poor management system, but an effective EMS, integrated into the company culture will also achieve compliance and probably do a better job than a compliance oriented system.

Moreover, it is important, particularly with the recent, revisions to the federal Sentencing Guidelines and the enactment of the Sarbanes-Oxley Act of 2002, to consider whether EMS are still providing the maximum protection and benefits.

Summary of Sentencing Guidelines Revisions

While, as noted previously, EMS should be management focused, it is also important to compare EMS against legal requirements, particularly when the legal requirements are beginning to recognize broader issues such as company cultures. A critical area for such review is the federal Sentencing Guidelines, which determine the sanctions that will be imposed in federal criminal cases. However, the Guidelines serve a much broader function in the area of corporate compliance programs, providing, if nothing else, “peace of mind” for corporate officials that the programs minimize potential exposure in criminal matters. These Guidelines, first promulgated in 1991 allow judges to show leniency based on whether or not the company’s compliance plan meet the Guidelines’ criteria for an “effective program to prevent and detect violations of law.”

The Guidelines’ criteria for sentencing also quickly became the criteria to determine which cases were selected for enforcement, and how seriously a particular violation may be viewed. Simply put, companies with compliance plans that did not meet the basic Guidelines requirements in the view of government personnel were almost automatically viewed as outliers seeking to avoid the legal responsibilities imposed by government regulations.

² See Steven Solow, Environmental Management Systems: Not Just for Environmental Compliance Anymore, *Executive Counsel* magazine, forthcoming, October 2004. A substantial portion of the discussion of the Federal Sentencing Guidelines is abstracted from that article, which ties my experience as a manager/lawyer to his experience as a lawyer/regulator to show the value of an EMS: “Frank Friedman, who served as the vice president for environmental health and safety at Elf Aquitaine, Inc., and who is now a nationally recognized expert on EMSs, long ago recognized the relationship between lawyers, engineers, business managers and consultants as the key to an EMS that meets a wide range of goals. His book, “Practical Guide to Environmental Management,” is in its ninth edition, and his observations in this regard—along with my own experience as a former government enforcer and current outside counsel to many highly regulated businesses—form the basis of some concrete steps, described below, that managers can take to increase their confidence in the protection and value provided by their EMS.” (Emphasis supplied)

His discussion of the federal Sentencing Guidelines and Sarbanes-Oxley, in turn, “forms the basis” for some of my recommendations.

The U.S. Sentencing Commission, the quasi-legislative body that drafts the Guidelines, has proposed a revision (the first since 1991) to Chapter Eight of the Sentencing Guidelines, the “Organizational Guidelines,” which govern the sentencing of companies. The changes to the Organizational Guidelines were partly in response to the new requirements imposed by Sarbanes-Oxley. The way the law operates, the Commission’s proposal will become law unless the U.S. Congress passes a law to the contrary, which is highly unlikely.

The new provisions will require new efforts in order for the government to consider that a corporate compliance plan is “effective” in preventing and detecting violations of law. Corporate directors and executives will be required to undertake a far greater responsibility and oversight role in the design and implementation of compliance plans and will for the first time require that companies show they have taken steps to promote an “organizational culture” that encourages a commitment to compliance.

The new Guidelines will do the following:

- For the first time require the organization to “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law”;
- More specifically define the term “standards and procedures” as “standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct”;
- Replace the general requirement that high-level individuals be assigned overall responsibilities with more specific requirements that clarify the roles and reporting responsibilities of an organization’s compliance authorities;
- Require more aggressive efforts by an organization to determine when an employee with substantial authority over a compliance area has a history of engaging in illegal activities or other conduct inconsistent with an effective compliance and ethics program;
- For the first time require training for and the dissemination of training materials to all levels of an organization’s employees and agents, including upper level management;
- Mandate the use of auditing and monitoring systems designed to detect criminal conduct;
- Require a periodic evaluation of the compliance program;
- Require that organizations provide a means, which may include the use of anonymous or confidential reporting, to enable employees and agents “to seek guidance regarding the potential or actual criminal conduct without fear of retaliation”; and
- Enforce compliance standards through “appropriate incentives,” in addition to disciplinary actions.

The EMS and those charged with its implementation should consider these changes and determine whether or not the existing program satisfies these requirements. Simply put, even a fairly well functioning EMS will be considered suspect in the

event of a violation if it does not address each of the new Guidelines provisions. I suggest that the integrated EHS management system, previously discussed will go a long way to achieving this objective.

The guidelines require a much broader look, particularly from an auditing standpoint at culture, namely whether the management system “promote[s] an organizational culture that encourages ethical conduct and a commitment to compliance with the law, ” mandates “the use of auditing and monitoring systems designed to detect criminal conduct” and “require[s] a periodic evaluation of the compliance program.” Do your auditing systems provide for such an examination? Do you have people in the auditing department capable of making such an examination or access to third parties who can provide such expertise?

Sarbanes-Oxley and EMSs

The Sarbanes-Oxley Act of 2002 is primarily about disclosure, imposing enhanced responsibility for disclosures upon top corporate officials. It puts increased pressure on corporate accountants and attorneys to push information “up the chain.” It requires CEOs and CFOs to certify, among other things, that the company has adequate “disclosure controls and procedures.” Sarbanes-Oxley also requires CEOs and CFOs to evaluate disclosure controls every 90 days and disclose to the company’s auditors and to the board’s audit committee all significant deficiencies and weaknesses in the design or operations of the controls.

These new obligations are placed on top of existing SEC requirements regarding the disclosures of environmental liabilities.³ Three existing SEC regulations and one financial accounting standard require the disclosure of “material” environmental liabilities.⁴

Sarbanes-Oxley has made the process of determining whether environmental costs and liabilities are “material” a matter of very critical personal liability exposure for the highest level of corporate officers. Anyone who certifies a periodic report that does not meet all applicable requirements is subject to fines and imprisonment—up to a \$1 million fine and 10 years of imprisonment for a “knowing” offense, and up to a \$5 million fine and 20 years of imprisonment for a “willful” offense.

A provision that is particularly important in the management and auditing context prescribes up to 20 years of imprisonment for destroying documents in order to obstruct a federal investigation, or even in anticipation of a federal legal proceeding. This broad new provision allows individuals to be prosecuted even if no official proceeding had begun, as long as the government can prove that the person destroyed records in contemplation of some official proceeding in the future. If nothing else,

³ Friedman, supra at pages 240-243. Solow, supra.

⁴ Friedman, supra.

this provision points up the importance of conducting a careful review of a company's records management program, above and beyond the EMS, given that it creates the potential for criminal liability for the destruction of documents in the ordinary course of a company's business.

One trigger for possible criminal prosecution is a history of violations, even if each one standing alone is itself relatively minor. While it is often stated that a strong EMS must have a feedback loop, that is not enough. Companies should have a program that works to promptly and accurately identify the root cause of a problem, considers a full range of potential future solutions, selects a solution that appears most likely to either remove the source of the problem or prevent a recurrence, and serves as a vehicle to manage a change in procedures, structure or operations. The paradigm is "plan, do, reflect, integrate."

A Compliance Assurance Letter is a very useful technique that I have used to ensure that each business unit is doing what it should in managing the EHS function. The president of a business unit is delegated substantial responsibility. The Compliance Assurance Letter, which the president of each Business Unit would be required to sign annually and submit directly to the General Counsel (with eventual submission to senior management and the Board, with a copy to the head of EHS), is a comprehensive document that provides a basis for ensuring a substantial portion of the accountability that must go with that responsibility. However, while the Compliance Assurance Letter needs to be coupled with other systems⁵, it is by its nature the most critical tool for providing the necessary corporate assurances that management systems are functioning effectively.

Many companies have general compliance letters, but these letters to be effective should include details such as processes developed and implemented to further compliance with applicable EHS regulatory requirements and company policies; the status of audit findings; and investigation processes for all significant EHS incidents and the implementation of measures to prevent their occurrences. Here, again, the focus is systems in place. A business unit head would also want similar letters from those reporting to him/her in order to assure that appropriate due diligence has taken place. This approach is not very different from Sarbanes-Oxley, but is designed not only for compliance but to provide further assurances that systems are in place and working effectively. It is not only a compliance tool, but also an effective management tool.

The Compliance Assurance Letter also accomplishes the purpose of bringing forward to management and the Board those issues that may need immediate attention and allows management and the Board to understand what actions, including funding, may be necessary for correction and to provide appropriate capital through the budget process as may be necessary.

⁵ See generally, Friedman, Practical Guide to Environmental Management (9th edition 2003, Environmental Law Institute)

The disclosure requirements and penalties of Sarbanes-Oxley, along with heightened government and shareholder attention to environmental liabilities, have prompted many companies to consider whether their EMS is providing an acceptable level of compliance and whether it is pushing information necessary for SEC filings up the corporate ladder.

Conclusion

In short, managers can no longer be satisfied if their EMS provides only compliance controls. They must also be confident that the EMS will allow the company's top managers to certify that adequate "disclosure controls and procedures" are in place regarding potential and actual material environmental liabilities.

These issues can be approached legally by urging managers and their counsel to address the new Sentencing Guidelines⁶ by reviewing their compliance plans for consistency with the new Guideline requirements. Similarly, regarding Sarbanes-Oxley, it is generally agreed that managers should determine whether their EMS can accurately identify, quantify and evaluate for disclosure environmental liabilities and costs. But a legal solution is not enough. Managers should also consider how a company's EMS can be enhanced in ways that may serve both compliance and the bottom line. An integrated EHS management system that is part of the culture that becomes "we just do it" fulfills those functions. Auditing for "culture" may be difficult because it is hard to develop standards, but in the words of the late Supreme Court Justice, Justice Stewart in examining pornography "I can't define it, but I know it when I see it." Auditors and managers need to understand this and/or get outside help to bring this to fruition. The exposure to a company's bottom line in not having an effective integrated EMS, not to mention its liability exposure is too great to take such risks.

⁶ The continuing validity of the federal Sentencing Guidelines, as presently utilized, is now under Supreme Court review. On June 24, 2004, the Supreme Court in a 5-4 decision voided a 90 month sentence that a Washington state court judge issued to Ralph Howard Blakely Jr. for kidnapping and terrorizing his estranged wife" on the basis that the sentence was more than three years longer than the maximum set by the state's guidelines. The sentence was based on a series of 32 factual findings by the judge who concluded that Blakely had acted with "deliberate cruelty." The Supreme Court held that Washington's system violated the Sixth Amendment because it allowed the enhanced sentence based of facts that no jury ever considered and that Blakely never admitted. *Blakely v. Washington*, No. 02-1632. The Supreme Court has scheduled for consolidated argument on October 4, 2004 two cases under federal law, where the issue of violation of Sixth Amendment rights is also presented. *United States v. Booker*, No. 04-104 and *United States v. Fanfan*, No. 04-105. See generally, John Gibeat, Compound Sentencing Problems-High Court to Take Another Crack at Federal Guidelines, ABA Journal e Report, August 8, 2004, www.abanet.org/journal/ereport/au6blakely.html In the meantime many federal prosecutors are seeking to revise indictments to include broader factual material to avoid potential Sixth Amendment issues.