Risk Management: The Role of Corporate Counsel in a Changing World

*Presented by ACC Canada and Borden Ladner Gervais LLP*

Wednesday, January 20, 2010
RISK MANAGEMENT: THE ROLE OF CORPORATE COUNSEL

INTRODUCTION DON ROSE

• What is the role?
• Formal?
• Informal?
• It is a key part of what we do
TODAY’S PROGRAM

• Theoretical Framework
• Methanex Risk Management Program
• Related and topical issues
• Questions
Ian Webb
BUSINESS RISK

Business Risk

• Risk of loss arising from the Company’s activities
• Anything that has the potential to result in negative consequences for the Company

Legal Risk (a subset of Business Risk)

• Risk of loss arising from the Company’s activities that results from the application of law
EXAMPLES OF BUSINESS RISKS

• Non-Legal Risks
  • Availability of capital
  • Commodity prices/currency fluctuations
  • Market acceptance of product/competition
  • Pandemic

• Legal Risks
  • Breach of contract
  • Failure to meet regulatory requirements
  • Failure to secure legal protection
Three Aspects of Risk Management Program

- Identification
- Evaluation
- Management
First Aspect: IDENTIFICATION

- Analysis of business activities - understanding the business process, interviews of operational personnel, and reviews of systems, policies and documentation
- What are the laws applicable to the activities?
  - laws of general application (e.g. contract law, employment)
  - industry specific laws (e.g. Health Canada)
- Are we in compliance?
- Are we taking advantage of protection or rights afforded by law?
  - e.g. - protection afforded by contract law or intellectual property law
EXAMPLES OF TYPES OF LEGAL RISKS

- Regulatory: industry specific regulations, competition/anti-trust, environmental, taxation, employment, privacy, health and safety
- Contract: breach - no contract - poor contract
- Board of Directors activities: fiduciary obligations - business judgment rule requirements
- Litigation
- Protection of Assets: intellectual property - use and protection of copyright and trademarks - patents
- Information technology: electronic contracts - libel - violation of advertising or disclosure rules - collection, use and disclosure of personal information
Second Aspect: EVALUATION

- Involves:
  - Assessing the potential impact on the Corporation and the probability of the threat
  - Prioritizing risks
  - Risk mapping can be helpful (probability vs. significance of outcome - both economic and organizational)
  - Mapping diagram
  - Program summary document
EVAULATION (Cont’d)

Magnitude of Impact

Likelihood of Occurrence

Priority 4
Low

Priority 3
Low

Priority 2

Priority 1
Once risks are identified and prioritized, the next step is to develop management strategies for each risk:

- avoid
- accept
- reduce
EXAMPLE MANAGEMENT COMPONENTS

• Assess who has the ball and their capability
• Allocate resources – ownership and accountability (defining responsibilities, setting up coordination and budgeting)
• Educate those responsible on legal obligations
• Develop a system to track contractual and regulatory legal obligations and compliance
• Establish corporate procedures, policies and best practices guidelines (e.g. contract policy, employee manual, stock trading policy, disclosure policy)
EXAMPLE MANAGEMENT COMPONENTS (Cont’d)

• Consider how to mitigate each risk
  • Mitigation of the problem, or
  • Mitigation of the impact (e.g. insurance or indemnities)
• Develop a process for dealing with existing or anticipated claims and proceedings
• Establish a protocol for engaging external advisors – identification of appropriate external expertise and development of relationship with legal service providers
EXAMPLE MANAGEMENT COMPONENTS (Cont’d)

• Implement an appropriate documentation and record keeping program
• Conduct periodic audits – measure performance
• Develop a crisis management protocol
• Establish a protocol for dealing with legal issues as they arise:
  • Develop reporting structures – early warning protocol
  • Immediate action protocol
  • Litigation hold process
EXAMPLE MANAGEMENT COMPONENTS (Cont’d)

• Learn the lesson – recording problems, causes and solutions - debriefings – updating standards, policies and best practices
ACC Lunch Presentation
Risk Management
January 20, 2010
Randy Milner
SVP, General Counsel and Corporate Secretary
Methanex Corporation
Understand the business – understand the risk

- Production Sites
  - Chile
  - Trinidad
  - New Zealand
  - Egypt (2010)
- 2008 Sales ~ 15% of global demand
- 2008 Revenues: US$2.3 Billion
- Low-cost Waterfront Shipping Subsidiary: ~19 vessels
- Employees: ~825
- Shares listed: NASDAQ, Toronto, Santiago
What methanol is used for..

Traditional Uses
(Mature Markets)

- **Formaldehyde**
  Pharmaceuticals, Wood Industry, Automotive
- **Acetic Acid**
  Fleece, Adhesives, Paints
- **Dimethyl Terephthalate**
  Recyclable plastic bottles
- **Methyl Chloride**
  Silicones

Energy Uses
(High Growth Potential Markets)

- **DME**
  (dimethyl-ether)
  Fuel Blending
Risk identification and management historically...

- Not an integrated activity
- Each dept. does its own thing
- No oversight
Management of risk

The most valuable thing to come out of the governance revolution?

“The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for: ...(c) the identification of the principal risks of the issuer’s business, and ensuring the implementation of appropriate systems to manage those risks”

- National Policy 58-201
Mx Strategic Risk Review Process

- Risk identification now a formalized process
- Development of a Strategic Risk Matrix
- Strong governance
  - Developed by senior management group
  - Reviewed by Audit Committee & Board
  - Annual review process
The 5 Basic Components of the Strategic Risk Matrix

1. Identify Strategic Risks
   - e.g. Adverse Political Actions; Gas Supply risk; Customer Demand; Access to Capital; Catastrophic Loss; Critical IT system failure; HR; etc.

2. Apply Inherent Risk Rating
   - (Extreme, High, Medium, Low)

3. Assess ability to mitigate each risk

4. Apply residual risk rating to each risk
   - (Extreme, High, Medium, Low)

5. Determine accountability
   - ID who is responsible for mitigation efforts; ID the mitigation efforts; ID which board committee has oversight
An Example ...
“Ethics and values”

1. Identify Strategic Risk
   - Maintaining high ethical standards as company moves into countries with reputation for bribery/corruption
   - Risk examples: dealings with corrupt public officials; FCPA action; employees thinking “cutting corners” during downturn is desirable
   - Potential impacts: loss of reputation; suits; penalties; jail; corroded morals; inability to attract quality talent; loss of focus on the business

2. Inherent Risk Rating
   - HIGH
3. Mitigation
- Current controls and mitigation practices
  - Hiring practices; strong corp. policies; code of ethics; compliance training;
- Future actions
  - Implement hi-level communication strategy (CEO video reminders & e-mails; Snr. Mgmt. in-region presentations; etc.)

4. Accountability (Risk Owner)
- Senior Management Team
- Reporting to Corporate Governance Committee

5. Residual Risk Rating
- LOW
Where Mx applies focus

- 20+ Strategic risks identified
- 5 identified where:
  - Inherent Risk: Extreme or High
  - Residual risk: Extreme or High
  - i.e. Limited ability to mitigate the risk
  - Lose sleep over these
- Where residual risk is lower, apply stronger mgmt control
Implications on workflow management on Legal Department

- Limited time and resources
- Need for triaging of risk issues
  - Decide which risk areas to get involved in and how
  - Internal v. external resources
### Triaging using 4-box process - #1

<table>
<thead>
<tr>
<th>Effort (FTEs)</th>
<th>High</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Value (Importance)</td>
<td>Administration/Management Advertising Review</td>
<td>Sales and Marketing Complex Litigation Compliance Employment Litigation</td>
</tr>
<tr>
<td>Low Value (Importance)</td>
<td>Benefits Logistics</td>
<td>Corporate/Securities Trade Practices</td>
</tr>
</tbody>
</table>

**Legend:**
- High Effort (FTEs)
- Low Effort (FTEs)
- High Value (Importance)
- Low Value (Importance)
Triaging using 4-box process - #2

<table>
<thead>
<tr>
<th>Inherent Risk</th>
<th>Management Critical</th>
<th>Action Plans Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>No Major Concern</td>
<td>Periodic Monitoring of Risk</td>
</tr>
<tr>
<td>Low</td>
<td>Thorough</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

Risk Mitigation
Triaging using 4-box process - #3
Thank you!
New Risks and Related Issues

Don Rose
New Areas of Risk

• To manage risk effectively, you must **identify** it
• To **identify** risk, you need a robust risk management program
• Theory and practice
• What gets measured, gets done
• Re-evaluate the information and assumptions
  • Methanex repeats the process annually
• Risks **change in unexpected** ways
• Forest and the trees
Topical and Related Issues

Some topical risk and risk-related issues:

- economic crisis affects risk and disclosure
- link between compensation programs and risk
- focus on corruption
- International Financial Reporting Standards IFRS
- global warming
- lobbyist registration
The Financial Crisis

the financial crisis

• customers can’t pay; suppliers can’t supply
• new supplier from politically risky country
• insurance to manage risk; is this a new risk?
• for many reasons, risk profiles increase
• disclosure gets more scrutiny from regulators
Continuous Disclosure

2009 - the Canadian Securities Administrators (CSA) regularly review continuous disclosure (current focus includes):

• reporting and disclosure issues associated with market conditions
• disclosure of pension funding obligations for issuers with defined benefit pension plans
• valuation and disclosure issues related to non-bank sponsored asset-backed commercial paper
**Compensation and Risk**

link between compensation program and risk

- “Risk” is the new buzz word in executive compensation (*Shearman & Sterling LLP, 2009 Director & Executive Compensation Survey*)
- Large bonuses under attack in the US, especially where support received under programs such as the Troubled Asset Relief Program (TARP)
- have compensation practices led to excessive risk taking?
- late 2009 SEC new proxy rules require disclosure on relationship of compensation policies and practices to risk management
Compensation and Risk

• narrative disclosure of policies and practices for all employees if they create risks that are reasonably likely to have a material adverse effect

• Canadian regulators not there - but much discussion about “say on pay” at AGM’s

• consequence - public, private or crown - shift to:
  • deferred compensation based on risk periods;
  • clawbacks of performance based compensation; and
  • intense disclosure obligations
Re(new)ed focus on corruption

- Canada criticised for lax policing
- US FCPA policed aggressively
- 1999 - Canada passed the Corruption of Foreign Public Officials Act – one $25,000 fine
- pressure to enforce
  - RCMP recently created an International Anti-Corruption Unit
  - 2009 federal bill would extend jurisdiction to offence committed outside Canada
- The point: no cutting corners in downturn
International Financial Reporting Standards (IFRS)

- conversion to IFRS completed by 2011
- a lot to do and little time left
- some unexpected issues
- how income and fixed assets are measured
- implications for legal departments:
  - may affect contracts
Global Warming: What risk?

global warming
  • all kinds of risk issues
    • Mississippi gulf coast land owners sue over Hurricane Katrina
    • a natural disaster?
  • related implications
    • Securities administrators will focus on disclosure of environmental matters
Conclusion and Q&A

Ian Webb

Conclusion and moderate Q & A
LEGAL RISK MANAGEMENT SUMMARY

Legal risks involve circumstances or actions that could, by application of law, have an impact on the Company’s profitability or ability to achieve its business strategies. The following identifies the Company’s more significant legal risks and discusses their assessment and the strategies that have been put in place to manage them.

Risks are rated based on the possible impact on the profitability of the Company if the circumstance or action should occur. They have also been rated based on the probability of occurrence.

Risks, ratings and management strategies are reassessed periodically and as circumstances warrant.

RATINGS

<table>
<thead>
<tr>
<th>Impact</th>
<th>High</th>
<th>Moderate</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Earnings:</td>
<td>&gt; $• mil</td>
<td>$• mil to $• mil</td>
<td>&lt; $• mil</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Likelihood:</th>
<th>Expected</th>
<th>Likely</th>
<th>Moderate</th>
<th>Unlikely</th>
<th>Rare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability:</td>
<td>Occurs almost annually &gt; 90%</td>
<td>Occurs every 2 to 3 years 40% to 90%</td>
<td>Occurs every 4 to 8 years 20% to 40%</td>
<td>Occurs every 9 to 15 years 5% to 20%</td>
<td>Occurs every 15 years or more &lt; 5%</td>
</tr>
<tr>
<td>Risk</td>
<td>Impact</td>
<td>Likelihood</td>
<td>Possible Cost ($ mil)</td>
<td>Legal Risk Management Action</td>
<td>Allocation of Responsibility/ Comments</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>----------------------</td>
<td>--------------</td>
<td>-----------------------</td>
<td>-----------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------</td>
</tr>
<tr>
<td>Breach of Banking Covenants</td>
<td>High</td>
<td>Unlikely</td>
<td>$●</td>
<td>Provide explanation to finance Diarize timing for compliance Remind finance (frequency) Receive reports from finance (frequency)</td>
<td>General counsel Finance</td>
</tr>
<tr>
<td>Breach of Material Contract</td>
<td>Moderate to High</td>
<td>Unlikely</td>
<td>$●</td>
<td>Establish and maintain a list of material contracts Identify covenants Set up monitoring and reporting system</td>
<td>General counsel</td>
</tr>
<tr>
<td>Incorrect Disclosure</td>
<td>Moderate to High</td>
<td>Unlikely</td>
<td>$●</td>
<td>Establish and monitor disclosure certification process Monitor legal disclosure requirements and their changes</td>
<td>General counsel Disclosure Committee</td>
</tr>
<tr>
<td>Selective Disclosure</td>
<td>Moderate</td>
<td>Unlikely</td>
<td>$●</td>
<td>Establish External Communication Policy Educate spokesmen on legal requirements Monitor public disclosure events. Prepare step by step process for dealing with inadvertent selective disclosure</td>
<td>Those officers who are tasked with talking to press and analysts. General counsel</td>
</tr>
<tr>
<td>Risk</td>
<td>Impact</td>
<td>Likelihood</td>
<td>Possible Cost ($ mil)</td>
<td>Legal Risk Management Action</td>
<td>Allocation of Responsibility/ Comments</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>-------------------</td>
<td>------------</td>
<td>-----------------------</td>
<td>-----------------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>Insider Trading and Reporting</td>
<td>Low/ Moderate</td>
<td>Unlikely</td>
<td>$●</td>
<td>Establish internal policy (including trading approvals and blackouts)</td>
<td>General counsel Insiders</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Educate insiders on the rules</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Establish periodic reminder</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Consider allocating filing responsibility to an employee</td>
<td></td>
</tr>
<tr>
<td>Product Liability Claim</td>
<td>Low</td>
<td>Unlikely</td>
<td>$●</td>
<td>Establish proper terms of sale and warranties</td>
<td>General counsel Operations personnel</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Ensure proper documentation of sales</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Litigation preparation (hold) memorandum</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Establish list of external legal experts</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Review Insurance</td>
<td></td>
</tr>
<tr>
<td>Failure to protect intellectual property</td>
<td>Moderate to High</td>
<td>Moderate</td>
<td>$●</td>
<td>Educate business personnel on legal requirements</td>
<td>General counsel Operations personnel</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Establish trademark and patent policy</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Ensure employment contracts deal with the Company’s rights</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Establish list of external legal experts</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Establish maintenance program</td>
<td></td>
</tr>
<tr>
<td>Failure to obtain a licence, permit or</td>
<td>Moderate to High</td>
<td>Moderate</td>
<td>$●</td>
<td>Establish a process to identify, obtain and monitor compliance with necessary authorizations</td>
<td>General counsel Operations personnel</td>
</tr>
<tr>
<td>other authorization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Breach of competition law</td>
<td>Moderate to High</td>
<td>Moderate</td>
<td>$●</td>
<td>Review sales practices</td>
<td>General counsel Operations personnel</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Educate business personnel on the do’s and don’t’s</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Monitor compliance</td>
<td></td>
</tr>
</tbody>
</table>