Of Counsel, Making Contractual Compliance Easier and More Manageable, (Jun. 1, 2025)

Of Counsel

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When businesspeople and lawyers think of corporate compliance, they usually focus on laws and government regulation. This should surprise no one since compliance programs arose in the context of government investigations of antitrust violations, the bribery of foreign officials to secure lucrative sales and contracts, and similar societal offenses. Most government focus on compliance has been related to its concern for criminal activity in those areas. Despite that provenance, though, one government group recommended that the mandate of an effective compliance program should include not just criminal activities within organizations, but rather all 'violations of law.'"

That perspective does not, however, serve as the proper basis on which private enterprise should consider a compliance program. One who looks at such programs through that prism misses a great opportunity. Such a narrow view of compliance could lead one to overlook some of the greatest benefits that a compliance program offers a company—and perhaps one of the few that represents a truly positive benefit, rather than one that consists solely of preventing bad things from happening or responding to the occurrence of violations of law.

Contractual obligations and benefits – The stepchild of compliance

The lifeblood of a company consists of its revenues and cash flow. A successful company takes steps to assure its continued receipt of payments due under its contracts and to minimize amounts that it must pay or credit to others on account of failures to honor any of its obligations under those agreements. Signing agreements for its services and products will be for naught if the company fails to honor its responsibilities and thereby forfeits its right to payments thereunder or incurs obligations that outweigh the benefits to which it is entitled under those agreements. Many compliance programs fail to include these arrangements in their scope. This disserves the organization as well as the compliance department.

Those benefits would follow the application of a compliance perspective to a company's contracting process. Assuring compliance with its obligations under private agreements thus occupies (or, more properly, should occupy) a more central position in a company's compliance interests than many realize.

Non-compliance with government mandates can lead to government orders that equate with a "death sentence" if carried to an extreme. Noncompliance with responsibilities to customers and other counterparties in a company's agreements, however, could lead to death by starvation if the company's cash flow dries up or dissipates due to penalties or other contractual results of its defaults.

In addition, a company that fails to honor its contractual obligations (or is seen to do so) will find it difficult to enter into agreements with other organizations. As a rule, businesses need to believe that their contractual counterparties can be relied upon to live up to their commitments. Otherwise, their ability to plan their affairs based on their entered-into agreements will be compromised.

Contractual compliance is relevant to this analysis in two ways: process compliance and substantive compliance. The first encompasses the process leading up to the commencement of a contract-based relationship. The second comes into play once a contract takes effect, when the contracting parties are obligated to honor their respective commitments to the others.

Compliance with the contracting process entails assuring that all of the policies and steps set out by a company's internal procedures for entering into an agreement (as well as any requirements of applicable law) have been addressed and met. Failure to do so could set up a default in the post-contract environment or even a contract that the party cannot enforce against its contracting partners. Consider a company that has entered into a corporate lending agreement with its primary source of financing that limits the company's ability to encumber its assets for the benefit of others. Were that company's representatives to fail to confirm their authority to commit certain assets to the satisfaction of its obligations under a potential agreement with a joint venture partner, they might enter into an agreement that by its very terms violates the pre-existing lending agreement.

One common "boilerplate" provision calls for a party to represent that it has entered into the contract in accordance with its internal procedures and external law, and that the person executing the contract on the company's behalf has authority to do so. A compliance program could include procedures to ensure satisfaction of the requirements precedent to entering into an enforceable contract and satisfaction of that boilerplate representation.

Compliance with the terms of the various and varied agreements to which a firm is a party constitutes a subset of its obligations to those outside the corporate entity, including government authorities, lenders, and the company's owners (whether shareholders or some other category). Each holds its own expectations vis-a-vis the organization's behavior under their relationship. The firm's contractual obligations, however, may be among the more specific and the more relevant on a day-to-day basis. Those obligations, and the organization's adherence to them, can have a more immediate impact on its financial fortune than many of the other obligations that it faces. Accordingly, every organization faces a considerable, and critical, challenge: assuring that it satisfies the requirements contained in its agreements. This requires attention to a number of issues, including these: meeting the substantive requirements (*e.g.*, completing work according to enumerated project milestones, giving the other party notice of certain events spelled out in the contract, providing the other party the opportunity to exercise certain negotiated rights, such as a right of first refusal, and satisfying the contract's itemized success goals, like sales targets); honoring deadlines; and meeting any other "tests" contained in the agreement for measuring that company's performance.

A key factor in ensuring proper performance under an agreement is more than just ensuring that individuals within the organization understand their respective responsibilities pursuant to the contracts; they must do so in a timely manner. This calls for a system to ensure that each person understands his or her role as well as the time when his or her action is necessary, as actions by different individuals often must be properly sequenced. Even the steps precedent to entering into valid contracts (the "process compliance" outlined above) require that certain actions occur in the proper order. Having the law department review a proposed agreement before it has been deemed to meet the company's business goals, for example, likely will result in wasted effort in at least some instances. This is true even taking into account that earlier involvement by attorneys can help the company avoid entering into arrangements that present problematic obligations that conflict with other commitments or applicable requirements.

Timely action by a company's employees can be critical to the ability to enforce a contract. Late action after a contract exists may constitute a default, and could in some instances reduce the contract's value to the parties even if enforceable. An appropriate "tickler" mechanism to alert employees when their involvement in certain types of matters (*e.g.*, proposed contracts, post-contract obligations, legal matters involving other parties, etc.) is necessary should be among the tools that an effective compliance department deploys as part of its contract-focused responsibilities.

Must the firm's business groups report to or depend on its compliance officer?

Whether a firm's business groups must report to or depend on its compliance officer depends on the specific regulatory environment, the firm's size and structure, and its internal risk management policies. However, there are strong arguments and regulatory trends that support a significant degree of independence and authority for compliance officers.

Many regulatory bodies emphasize the importance of compliance independence. This independence allows compliance officers to objectively monitor and enforce adherence to laws and regulations without undue influence from business units. Regulations often require firms to establish clear reporting lines that ensure compliance officers have direct access to senior management and the board of directors.

A robust compliance program typically involves clear reporting lines to senior management or the board. It should include the following: the authority to investigate and address compliance issues; the ability to provide independent advice and guidance to business units; and the resources necessary to effectively monitor and enforce compliance.

In smaller firms, the compliance function might be integrated with other roles. However, even in these cases, it's essential to maintain a degree of independence. Larger, more complex firms often have dedicated compliance departments with clear reporting lines to senior management or a chief compliance officer (CCO). It is very common for business groups to depend on the compliance officer for guidance.

While the business groups may not always report directly to the compliance officer, they should depend on the compliance officer for guidance and advice on regulatory matters. The compliance officer should be seen as a resource for the business groups, helping them to understand and comply with relevant laws and regulations. The compliance officers develop and implement policies and procedures that the business groups must follow. The compliance officers also may provide training and education to business group personnel on compliance matters. In summary, while the exact reporting structure can vary, a strong compliance function requires independence and authority.

How broad is the role of the compliance officer?

The role of a compliance officer has expanded significantly, reflecting the increasing complexity of regulatory environments across various industries. The compliance officers ensure that their organizations adhere to all applicable laws, regulations, and industry-specific guidelines. This involves staying informed about changes in legislation and implementing necessary adjustments to internal policies. The compliance officers identify, assess, and mitigate potential compliance risks.

Their responsibilities typically include conducting risk assessments, developing control measures, and monitoring their effectiveness. The compliance officers create and implement internal policies and procedures that guide employee behavior and ensure adherence to regulatory standards and educate employees on relevant laws, regulations, and internal policies, fostering a culture of compliance within the organization. They also conduct regular audits and monitor activities to detect and prevent compliance violations. The compliance officers investigate potential compliance breaches, gather evidence, and report findings to senior management and, when necessary, regulatory authorities. In essence, the role of a compliance officer is broad and multifaceted, requiring a deep understanding of regulatory requirements and a commitment to promoting ethical conduct within the organization, in addition to understanding the organization's business and operations.

Does the role of a compliance officer eclipse or co-opt the roles of other corporate officers who have traditionally overseen the contracting and related processes?

The compliance function does not replace or undermine the responsibility of corporate officers to ensure that the company complies with law. It's more accurate to say that the compliance officer's role interacts with and provides an overlay of scrutiny to the roles of other corporate officers and assistance to those officers, rather than eclipsing or co-opting them. The compliance officer's function is to ensure that all business activities, including contracting, adhere to relevant laws, regulations, and internal policies. Other corporate officers, such as contracting officers or procurement managers, retain their core responsibilities related to the practical aspects of contract negotiation, execution, and management. The compliance officer provides oversight by developing and implementing compliance policies related to contracting. They monitor contract-related activities for potential compliance risks and provide guidance on regulatory requirements and ethical considerations.

Effective contract compliance requires collaboration between the compliance officer and other relevant departments. This ensures that compliance considerations are integrated into the contracting process from the outset. Contracting officers possess specialized expertise in contract negotiation and management, while compliance officers have expertise in regulatory compliance. These are distinct but complementary areas of expertise.

While compliance does encompass many elements of an organization's operations (consider, as one example, that compliance with manufacturing standards comes into play on the factory floor and touches, in many cases, on technical issues and union rules), the compliance function should serve a coordinating and recordkeeping role more than anything else. Assuring that the appropriate corporate functional unit addresses its particular compliance responsibilities enables the corporate compliance department to enforce the various compliance-related activities that occur throughout the organization.

Take the example cited above: the compliance department can assist the sales group to adopt a “tickler” system that increases the efficiency and effectiveness of that sales group, including plotting the appropriate sequence of “alerts” for the sales team. This does not mean the compliance personnel take over the sales group's responsibilities of selling the company's products and services.

An effective compliance department does not replicate other corporate functions; rather, it creates mechanisms that track the performance of those other units in respect to those activities that relate to the company's compliance with the expectations that apply to its operations. No organization should ignore the need to comply with expectations of every party with a legitimate interest in its affairs. In the context of contractual compliance, this will entail the expectations of its contracting partner and even those who, while not privy to the contract in question, would react negatively to a demonstration by the company of indifference to its contractual obligations.

Assuring that the other units of the company develop policies that address legal and contractual compliance constitutes the compliance department's responsibility in respect to that issue. Responsibility for drafting the policies should lie with the groups that possess the necessary knowledge of the business processes involved. By assisting the various units in the company (e.g., sales, marketing, customer service, legal, etc.) to create ongoing compliance-assurance mechanisms, a compliance department will accomplish the following: strengthen the company's competitive posture; improve the reliability of its cash flow; improve customer relations; reduce the likelihood of disputes and litigation (both of those drain resources from more productive uses); improve the ethical culture of the organization; and, finally, those benefits for the company will serve the interests of the compliance department itself as its role will be seen as more than just preventing the occurrence of bad things. The department's assistance to other units of the company will enable them better to realize the company's business objectives and assure the continued revenue stream that constitutes its lifeblood. A firmer base of support within the company, particularly among senior management, should result from those efforts.

In essence, the compliance officers act as a safeguard, ensuring that contracting activities are conducted ethically and legally and they work in conjunction with other corporate officers to minimize compliance risks and promote a culture of compliance. Therefore, rather than taking over the roles of other officers, the compliance officer adds a crucial layer of oversight and guidance to ensure that all contracting activities are conducted within legal and ethical boundaries.

Capturing the benefits and obligations of contracts and other arrangements

What would that effort require? First and foremost, the compliance department must have and maintain a catalog of the company's contractual and other obligations. Only by knowing what is expected of the company can the department know how to help the organization comply with those obligations. Compiling such a catalog, though, means combing through the myriad documents that reflect the firm's agreements and identifying the relevant provisions of those documents that evidence the obligations.

This certainly can be done the old-fashioned way, by having employees read all the documents and capture the relevant information from them in one or more databases. This approach, though, is far from foolproof. Particularly when the number of documents to be reviewed and analyzed is large or multiple reviewers are involved in the project, the possibility of inconsistent results is great. Relevant provisions might be missed by human eyes. Even with well-prepared guidelines for the review, different reviewers might reach disparate conclusions. The data in those materials might be formatted inconsistently.

With the goal of capturing as much information as possible in respect to the firm's contractual obligations and benefits, a compliance department should consider automating the process of collecting and organizing those data. With AI-powered abstraction software, a company can quickly assemble a veritable encyclopedia of its contractual commitments. Doing so in the form of a single or connected series of databases would enable its employees to maintain control over its obligations and those of its counterparties. As the organization enters into new agreements, it can add them to that resource easily and quickly.

The integration of artificial intelligence (AI) into contract management tools significantly enhances the ability to capture and manage the benefits and obligations of contracts. AI-driven automation is transforming this process, offering greater precision and efficiency by analyzing complex legal language within contracts. This allows for the automated extraction of crucial information, such as the following: key dates and deadlines; payment terms; obligations and responsibilities of each party, risk factors, and potential liabilities surpassing simple keyword searches, as AI can understand the context and meaning of contractual clauses. AI can assess contract risks by identifying potentially problematic clauses or inconsistencies. This enables proactive risk mitigation, helping organizations avoid costly disputes.

AI-based contract management tools streamline various stages of the contract lifecycle management process by generating contract drafts based on templates and past agreements; by automatically reviewing contracts for compliance with internal policies and legal regulations; by tracking key contract milestones and generating alerts for upcoming deadlines or potential breaches. AI can analyze vast amounts of contract data to identify trends and patterns, thus providing valuable insights for optimizing contract performance and improving future negotiations. AI helps ensure compliance with evolving regulations by automatically identifying and flagging potential compliance issues.

AI-powered contract management tools provide a comprehensive view of contract data by capturing, analyzing, and managing contractual obligations and benefits. It enables informed decisions by minimizing human error in data extraction and analysis and significantly reduces the time and effort required for contract management. AI helps identify and mitigate potential risks, reducing the likelihood of costly disputes. In essence, AI-integrated contract management tools have revolutionized contract management leading to more efficient, accurate, and risk-averse contract management practices.

How AI-integrated contract management tools make contractual compliance easier and more manageable

AI-integrated contract management tools are significantly streamlining and enhancing contractual compliance, making it more manageable for organizations. AI analyzes vast amounts of contract language, extracting key compliance-related information. This includes identifying clauses related to regulatory requirements, data privacy, and industry-specific standards. This reduces the risk of human error in manual reviews, ensuring that all relevant compliance obligations are identified. AI algorithms can detect potential compliance risks by flagging non-standard clauses, inconsistencies, or deviations from regulatory requirements, which allows organizations to address potential issues before they escalate into costly disputes or penalties. AI-powered tools continuously monitor contracts for changes in regulations or internal policies and can automatically generate alerts and notifications when updates are required, ensuring ongoing compliance. AI can generate automated reports on contract compliance, providing stakeholders with clear and concise insights, which simplifies compliance audits and ensures that organizations can demonstrate their adherence to regulatory requirements. AI-integrated tools often include centralized repositories for storing and managing contracts, creating a single source of truth for all contract data, making it easier to track compliance obligations and ensure consistency. AI minimizes the risk of human error, ensuring that contracts are accurately reviewed and that compliance requirements are consistently applied. In addition, AI-powered tools can send out automatic alerts for upcoming compliance deadlines, renewals, and other important dates. This helps businesses avoid missing crucial obligations. In essence, AI-based tools help organizations minimize risks, reduce costs, and ensure that they meet their contractual obligations.

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