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CRISIS MANAGEMENT:
The Economy, Security and Coping with the Unexpected

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Crisis Management:
The Economy, Security and Coping with the Unexpected

A Practical Guide to Preparing for and Responding to a Crisis

by

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INTRODUCTION

During the last few months, two events dominated the headlines of every newspaper, magazine cover, and news program. Both events -- the attacks of September 11 and responses and the Enron bankruptcy -- are appropriately described as crisis situations, and at every turn, their respective players are being evaluated on how they have handled the crises.

History shows that both events will leave a legacy long after the crisis situation is extinguished. For example, Johnson and Johnson is still praised for how it handled its 1982 crisis involving the tampering and cyanide poisoning of Tylenol capsules. Meanwhile, despite making good technical decisions, Exxon's public relations decisions during the Exxon Valdez oil spill are still cited as examples of what not to do in a crisis situation.

In corporate crisis situations, a company must make the right decisions and must make them under extremely difficult pressures, including constraints on both the time and resources to develop a crisis response. A crisis situation may also require the company to choose between competing corporate interests. Many crisis situations bring the threat of civil or criminal litigation, and the company may naturally want to minimize potential liability, as well as protect confidential information. However, in certain crises, the company may be better served by disclosing confidential information, particularly when the crisis response involves investigations by governmental agencies or the crisis threatens public health and safety.

Today, more companies understand the importance of having a crisis management team and are, therefore, better prepared to handle crisis situations. Still, many companies are unprepared either because they have not planned at all for a crisis or because they have not taken the necessary steps to prepare for a crisis.

The need for effective crisis management is not limited to large corporations. Crises are non-discriminating and can strike small companies or sole proprietorships just as easily as Fortune 500 corporations. For example, in 1989, after a 5-year-old boy drowned in the swimming pool at a small West Los Angeles, California day camp, the owners called for help in the form of a crisis management company. The company helped manage the crisis by communicating with the boy's parents, the parents of other campers, the community, and the press.

Unfortunately, there is not a "model" that a company can use to prepare for and handle a crisis. Crises come in many forms and different degrees of severity. Moreover, the types of potential crises depend greatly on the nature of a company's business. For example, environmental hazards or products liability claims are not crisis situations for which all companies must prepare. Still, a review of past corporate crises shows that some generalizations can be made as to practical steps to follow and pitfalls to avoid when preparing for and handling crisis situations.

The starting point is understanding exactly what a crisis is. For purposes of this guide, a crisis is considered to be an unexpected and negative development with the potential for highly undesirable consequences, including public health and safety dangers, criminal liability, significant civil liability, and/or loss of significant company value, regardless of how well the crisis is managed. In most instances, a crisis is also characterized by an element of suddenness that requires prompt attention at the highest levels of the organization.

As a general proposition, effective crisis management has two principal goals. An initial goal is to identify and reduce or eliminate risks that could potentially trigger a crisis. A secondary goal is to be prepared to handle a crisis efficiently and properly, thereby reducing the scope of potential damage to the corporation caused by some or all of the following:

- **Public Health & Safety:** In crisis situations that create public health and safety dangers, the company's first priority must always be to take any measures necessary to alleviate that risk. The consequences of failing to do so are disastrous.

- **Loss of Consumer Confidence:** The Tylenol cyanide poisoning could have resulted in a loss of consumer confidence. However, Johnson and Johnson effectively managed the crisis, and today, Tylenol is still a leading product in pain medication.

- **Loss of Distributor or Retailer Confidence:** Distributors and retailers do not want to be identified with defective products, even if the distributor or retailer played no part in manufacturing the product or where the safety allegations are false.

- **Loss of Investor Confidence:** Depending on the severity of the crisis, the company may see a loss of investor confidence. In most cases, the company should rebound. In severe cases, however, investor confidence may dip low enough to render the company insolvent or make the company the target of a hostile takeover.

- **Loss of Regulatory Agency Confidence:** Companies in highly regulated industries often depend on good will with government regulatory agencies and work hard to promote it. A crisis event could affect the goodwill the company has worked to establish.

- **Civil and Criminal Litigation:** Most crises trigger some form of litigation, such as products liability suits, wrongful death actions, negligence lawsuits, shareholder derivative suits or criminal litigation.

Some crisis situations present multiple threats, and strategies for addressing these threats may be at odds with each other. For example, nearly all crisis situations pose a threat of civil or criminal litigation. As a result, a company's initial response to a crisis situation might focus on avoiding liability and protecting privileged and confidential information. However, some crises present other, and often more long-term, severe threats than litigation. Specifically, in responding to a crisis, often nothing is more important than maintaining public, government and/or investor credibility. The ability to maintain credibility with the these groups may depend on the disclosure of confidential information. While disclosing confidential information could change the landscape of how the company handles pending litigation, the company may be better served by maintaining its credibility. For example, cooperating with a regulatory agency may be valuable in convincing the government either to not bring criminal charges or to enter into a favorable settlement agreement with the company.

Similarly, the corporation must consider its long-term interests. Short-sighted measures that seem to help the corporation's immediate issues may damage the corporation in the long run. For example, the corporation may resist instituting a product recall because of the extraordinary costs and resources that are associated with such measures and because of fear that the public will interpret the recall as an admission of fault. While this is a valid concern, the company may be better served by instituting a voluntary recall, which could increase the company's good will with the government and public by providing credible evidence that the company places public health and safety ahead of profits.

Finally, there is one common thread to managing all types of crises -- the importance of gaining a prompt and thorough understanding of the facts. Accurate knowledge enables the company to correct the problem, maintain credibility with the government and public, handle victim relations, address media questions and concerns, and prepare for litigation. On the other hand, ignorance of the facts compounds the crisis situation. If it does not know the facts, the company cannot effectively address the situation and may appear to be inept or to be engaged in a "cover-up."

I. "BE PREPARED": HOW TO PLAN FOR A CRISIS

A prerequisite to successful crisis management is advance preparation. A crisis, by its nature, requires a quick and coordinated response by multiple individuals, with significant dangers resulting from mistakes. Without a plan in place for dealing with such an event, the company significantly increases the likelihood that the crisis will be mishandled.

- **STEP 1: Assemble a Crisis Management Team**

The first step in crisis preparedness is formation of a crisis management team. A company should not rely solely on its officers and management to manage a crisis. Crisis management has become a specialized discipline that depends more on specialized areas of expertise than on business expertise. The size of the team will vary depending on the particular needs of the company. The company should coordinate various areas of expertise within and outside the corporation, including:

1. <u>Legal Counsel</u>: Legal counsel will have multiple roles on the team, including preparing for and handling litigation, identifying potential areas of civil and criminal liability and identifying legal obligations. In addition to in-house counsel, the company should consider including outside counsel with specialized expertise in relevant areas of the law, such as products liability or environmental law.

2. Investigators: Investigators are often important members of a crisis management team. Many crisis events require the company to conduct a prompt and thorough internal investigation. The internal investigation will be a key component of the crisis management plan as it will help the company determine the facts, identify potential legal liability, and develop appropriate responses. For the reasons discussed below, the company should consider having outside counsel conduct and lead the investigation.

3. Public Relations Personnel: The company should consider including both in-house and outside public relations personnel on the team. The public relations personnel will be involved in preparing public relations guidelines and issuing company statements in response to crisis events. Public relations personnel can also assist in preparing mock crisis situations to help identify areas that the crisis management team needs to strengthen.

4. In-house Investor Relations Personnel: Including investor relations personnel can help address two dangers. First, a crisis can cause investors to sell stock, affecting the company's stock price. Second, regardless of how well the crisis is managed, investors may pursue shareholder derivative suits, claiming that directors, officers and/or senior management breached their fiduciary duties either by allowing the crisis to happen or by not managing the crisis appropriately. Therefore, the company should consider including investor relations personnel that can assist in identifying ways to reassure investors during and after the crisis.

5. Government relations personnel: Some crisis events trigger either a duty by the company to report the incident or an investigation by a government agency such as the FAA, FDA or SEC. In these situations, the crisis management team may need government relations personnel to help facilitate a cooperative effort between the company and the agency.

6. The Risk Manager/Insurance Personnel: A crisis could also trigger multiple insurance claims, requiring personnel experienced in handling insurance claims and other insurance related issues. Furthermore, if the crisis triggers shareholder derivative suits, the company will need to take steps to preserve its ability to seek coverage under potentially applicable insurance policies. Insurance personnel will also be important in making sure that there is adequate coverage to respond to crisis situations.

7. Finance personnel: Finance personnel will not only help create an appropriate budget for managing the crisis, but will help identify and manage post-crisis financial issues presented by possible losses of profits or assets.