

Compliance Due Diligence during M&A Transactions

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What this Program Will Do

- Give an overview of the challenges, considerations and risks that arise during the M&A Transaction process.
- Share practical tips and solutions for effectively conducting pre-acquisition due diligence and mitigating associated risk.
- Discuss strategies for effectively integrating ethics and compliance programs and related infrastructure after the deal closes.

What this Program Won't Do

- Provide Substantive Answers to Specific Compliance Concerns
- Tell You Exactly What Compliance Concerns You May Have for a Particular Transaction

Pre-Acquisition Steps

- Explaining why your M&A team needs Compliance Due Diligence
- Allocation of Resources
- Training and Preparation

“Don’t Buy Trouble”

- Get the team on board with the “Why”
- Common Objections:
 - We’ve never needed it before.
 - We can fix that after we make the purchase.
 - The Target is not in any current trouble.
 - It will take too long.
 - It might stop the deal.

Reasons for Due Diligence

Effective Responses:

- Times have changed.
- We need to know exactly what we are buying before we sign.
- The consequences of ignorance exceed the costs of due diligence.

Example # 1: *Goodyear*

BACKGROUND:

- 2006: Goodyear purchased ownership interests in certain African-based businesses.
- From 2007-2011, those acquisitions paid bribes of approximately \$3.2 million.
- The bribes were recorded as legitimate business expenses.

IMPACT:

- The U.S. Securities & Exchange Commission (SEC) determined that Goodyear violated the books and records provision of the FCPA.
- Goodyear agreed to settle by paying over \$16 million and conducting certain remedial activities.

KEY QUOTE:

“Goodyear did not detect or prevent these improper payments because it failed to conduct adequate due diligence when it acquired Treadsetters, and failed to implement adequate FCPA compliance training and controls after the acquisition.”
Order at ¶ 11.

Example # 2: *Scotts Miracle-Gro*

BACKGROUND

- Scotts Miracle-Gro purchased a bird food producer. That producer improperly used pesticides to treat its product to prevent infestation.
- Scotts Miracle-Gro continued that use for two years after the purchase.
- Once detected, Scotts Miracle-Gro informed the appropriate government officials and conducted a recall.

IMPACT

- Scotts Miracle-Gro plead guilty to a misdemeanor and paid a multi-million dollar fine in 2012.
- It is currently defending a class action lawsuit for its sales of bird food that were improperly treated.

KEY FACT

- Scotts Miracle-Gro paid \$77 million to enter the bird food business in 2005. It sold the bird food business in 2014 for \$7.2 million.

Example # 3: *Worthington Industries*

BACKGROUND

- In 2012, Worthington Industries purchased Westerman Companies. Both companies are based in Ohio.
- In November 2014, Worthington Industries learned that the U.S. Department of Justice is investigating Westerman for alleged payment of bribes to a Russian state-owned company.
- Westerman is alleged to have paid tens of thousands of dollars in bribes between 2011 and 2013 to keep its business with the company.

IMPACT

- This case is still pending, so it is unclear whether or not bribery even occurred. Worthington Industries, however, is incurring monetary costs related to its defense along with the negative publicity associated with the investigation.

KEY QUOTE

- According to the Wall Street Journal, Worthington Industries' general counsel "stressed that Westerman's ties with the Russians began before Worthington acquired it. 'When we became aware of this [investigation], we quit selling to them,' he added."

Training

- Determine the Team
- Risk Assessments
- Issue Spotting
- Reporting Structure

Allocation of Resources

- Determine in advance who will do what
- Avoid resource fights in the midst of the transaction
- Be flexible
- Don't quit your day job

The Negotiations Start

4 steps:

1. Nature of Transaction
2. Risk Assessment
3. Issue Spotting
4. Resolution

Nature of Transaction

- Are you buying or merging?
- Cash, stock or both?
- Desired end goal

Risk Assessment

- Industry
- Potential Liabilities
- Known Problems
- Potential Sources of Unknown Problems

Issue Spotting

- Based on Risk Assessment
- Determine key areas to check (e.g., antitrust, anti-corruption, environmental, etc.)
- Provide Checklists to enable M&A Team to spot potential issues

Checklists

- Provide instructions on use
- Obtain general background information (e.g., company structure, address, list of officers and directors, etc.)
- Have a checklist for general compliance and ethics plus separate checklists for each substantive area applicable to the deal

Sample Instructions

- **PURPOSE:** During the due diligence phase of a merger or acquisition, this Checklist should be used to determine if there are any particular compliance risks that should be investigated further for the compliance categories indicated in the Table of Contents.
- **INSTRUCTIONS:** For each category listed below, obtain answers from the potential merger or acquisition target (the “Company”) for each of the questions asked in the Checklist. When the response requires additional documents, obtain those documents from the Company. Upon completion of the Checklist, send the completed Checklist to the Chief Compliance Officer, or any appropriate designee, for review. The Compliance team will review the Checklist and follow up with the Due Diligence team should any issues arise.

Sample Checklist

GENERAL COMPLIANCE & ETHICS PROGRAM	
1.	Does the Company have a Code of Ethics? <input type="checkbox"/> Yes <i>(If yes, ask for copy.)</i> <input type="checkbox"/> No
2.	Does the Company provide Code of Ethics training to its employees? <input type="checkbox"/> Yes <input type="checkbox"/> No
3.	If yes, how often does the Company provide training?
4.	Does the Company keep records of its training? <input type="checkbox"/> Yes <i>(If yes, ask for copies of records showing attendance.)</i> <input type="checkbox"/> No
5.	Does the Company provide a Hotline for its employees to report concerns or ask questions? <input type="checkbox"/> Yes <input type="checkbox"/> No
6.	If yes, how many Hotline reports were received in each of the last three (3) years?
7.	If yes, how does the Company publicize the Hotline?
8.	If yes, is the Hotline accessible in all countries where the Company has employees? <input type="checkbox"/> Yes <input type="checkbox"/> No
9.	If yes, is the Hotline available in all languages spoken by the Company's employees? <input type="checkbox"/> Yes <input type="checkbox"/> No
10.	If yes, do the employees have the option to report anonymously? <input type="checkbox"/> Yes <input type="checkbox"/> No
11.	If no, what other mechanisms exist for employees to report concerns or ask questions?
12.	Obtain copies of all compliance risk assessments conducted during the past 5 years.

Resolution

- Review Checklists
- Highlight Concerns
- Determine next steps
 - Require Remediation before deal closes
 - Cancel Deal
 - Plan to fix after deal closes

After the Wedding

- Integration
- Remediation

Integration Factors

- Exhaustion: Fatigue hits after the deal closes – need to stay focused.
- Timing – Be prompt but not unreasonable
- Culture – Be mindful of differences and Stay Positive
- Document

Integration Checklists

- Checklists needed for general compliance and ethics as well as appropriate substantive areas.
- Checklist should cover two areas
 - Integration of Company policies and procedures
 - Remediation of known issues discovered during Due Diligence
- Set deadlines, but be reasonable
- Require attestation to completion of checklists and any known deficiencies

Sample Instructions

- **PURPOSE**: Ensure that the appropriate compliance actions are taken within the new acquisition to educate the new employees, resolve any outstanding compliance concerns and protect the Company.
- **INSTRUCTIONS**: The Integration Manager assigned for the acquisition shall work with the Compliance Officer for the acquisition to ensure that the actions listed below are completed within the deadline set forth below. Within [120] days of the closing date, the Integration Manager and the Compliance Officer shall complete the attached attestation.

Sample Integration Checklists

1. GENERAL COMPLIANCE & ETHICS PROGRAM

	ACTION	TIMING
1.	Determine Compliance Officer(s) for Company	Within first 60 days
2.	Issue Code of Ethics to All Employees	Within first 60 days
3.	Issue Hotline information to All Employees	Within first 60 days
4.	Post Ethics and Compliance Posters in Company's Facilities and Offices	Within first 60 days
5.	Give Code of Ethics training to All Employees	Within first 90 days
6.	Take steps to mitigate risks discovered during due diligence	Within first 90 days

2. ANTI-BRIBERY & CORRUPTION (ABC) COMPLIANCE PROGRAM

	ACTION	TIMING
1.	Issue Anti-Bribery & Corruption Policy and Procedures to All Employees	Within first 60 days
2.	Issue Code of Ethics, Anti-Bribery & Corruption Policy and Handbook to All Third Party Agents	Within first 90 days
3.	Take steps to mitigate risks discovered during due diligence	Within first 90 days

Sample Attestation

ATTESTATION TO THE COMPLIANCE INTEGRATION CHECKLIST

Except as otherwise listed below, we have completed the items on the attached checklist:

Deficiencies

Plan to Resolve

Integration Manager

Date

Compliance Officer

Date

Parting Thoughts

- Be flexible where you can and firm where you have to be
- Communication is key – can't resolve an issue until it is known
- Documentation is key to an effective defense should something go wrong

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