

Effective Ethics & Compliance Due Diligence during M&A Transactions

Kasey T. Ingram, JD, CCEP

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

Why is Compliance Due Diligence Important?



- To ensure that any non-compliant activities are discovered and addressed in advance of closing.
- To allow for easier integration of the compliance & ethics culture after closing.
- The U.S. Department of Justice expects you to do it.

USDOJ Checklist for Evaluation of Corporate Compliance Programs

“Mergers and Acquisitions (M&A)”¹⁰



- **Due Diligence Process** – Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What has been the M&A due diligence process generally?
- **Integration in the M&A Process** – How has the compliance function been integrated into the merger, acquisition, and integration process?
- **Process Connecting Due Diligence to Implementation** – What has been the company’s process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company’s process for implementing compliance policies and procedures at new entities?”

¹⁰ USDOJ FCPA Guide, p. 62.

Objectives of Compliance Due Diligence

- Define the target company's compliance risk profile
- Uncover red flags
- Uncover past or ongoing violations in key areas, such as
 - anti-bribery laws
 - antitrust regulations
 - data protection rules
 - trade regulations
 - worker safety requirements

Pre-Acquisition Steps

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

Thoughts:

Don't Buy Trouble: The valuation of the target must reflect reputational risk, as well as successor liability.

Due diligence will help establish the true value of the target and determine whether bringing the post-merger company into compliance could jeopardize the acquirer's profitability or result in criminal liabilities for past violations.

Common Objections

• 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.

Effective Responses:

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

Example # 1: Goodyear

BACKGROUND:

- 2006: Goodyear purchased ownership interests in certain African-based businesses.
- During the period 2007-2011, the acquired companies 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: Harris Corporation

BACKGROUND

- The Chairman & CEO of a Chinese subsidiary of Harris Corporation engaged in a practice of illegal gift-giving paid for through false expense claims that were then improperly recorded in Harris' books & records.
- "Although only able to perform limited pre-acquisition due diligence on the subsidiary, Harris took immediate and significant steps after the acquisition to train staff in China and integrate the subsidiary into Harris's system of internal accounting controls. As a result of Harris's postacquisition measures, including the implementation of an anonymous complaint hotline, Harris discovered the misconduct at the subsidiary within five months of the acquisition."
- The SEC found that the Chairman & CEO of the Chinese subsidiary "violated the anti-bribery, books and records, and internal accounting controls provisions of the Securities Exchange Act of 1934."

IMPACT

- The Chairman & CEO of the Chinese subsidiary consented to the entry of a cease-and-desist order and the payment of a \$46,000 civil penalty. No action was brought against Harris Corporation.

KEY QUOTE

"The SEC determined not to bring charges against Harris, taking into consideration the company's efforts at self-policing that led to the discovery of Ping's misconduct shortly after the acquisition, prompt self-reporting, thorough remediation, and exemplary cooperation with the SEC's investigation."

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 (If yes, ask for copy.) <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 (If yes, ask for copies of records showing attendance.) <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

If a robust pre-acquisition compliance due diligence cannot be performed—for example, due to insufficient time in bidding procedures—the DOJ sees an obligation to implement a post-closing review plan for non-compliance and respective disclosure, upon detection.

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

Post-merger organizational changes may exacerbate compliance risks by distracting employees, creating new control gaps and affecting company culture.

Multichannel compliance communication as soon as practical before the change via direct managers and with a strong emphasis on integrity is known to reduce misconduct significantly and improve the perception of a culture of integrity.

The Nuts and Bolts of Integration & Remediation



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

Remediation



- Guided by the Checklists
- Do not expect a miracle – be reasonable about time
- Document & Follow-up

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

Soft Skills Can Have A Hard Impact



Maintain Balance

Soft Skills Focus on Relationships – Hard Skills Focus on the Task



Get the Job Done

BUT

Do not sacrifice a long-term impact
to gain a short-term victory

What are examples of Soft Skills?

- Listen more than you talk
- Keep a Positive Attitude
- Be Approachable
- Take the lead to move things forward
- Be inclusive and collaborative
- Look and Act like a Professional
- Be Patient and Give Grace as needed



CULTURE – CULTURE - CULTURE

- Culture can make or break your compliance & ethics program.
- Culture change requires trust and acclimation.
- You should only expect what you inspect.



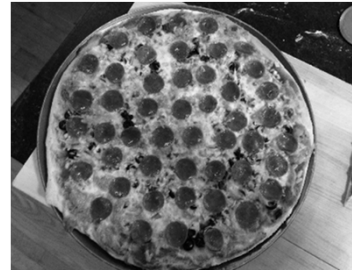
If You Want to Succeed, You Gotta Show Up

- Long-distance relationships are difficult.
- You won't really know what the culture is until you live it.
- Internal Networks are vital.



GIVE IT AWAY

Use branded items to market the program



Use food to increase attendance

Semper Gumby

- Don't lose what you bought.
- Shared values are important – be flexible about style.
- Patience & Repetition



Parting Thoughts



- If you're not there, it appears you don't care.
- 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

Kasey T. Ingram
General Counsel & Chief Compliance Officer
ISK Americas Incorporated
IngramK@ISKAmericas.com
[@KaseyIngramJD](https://www.instagram.com/KaseyIngramJD)