

Managing M&A Risk: Essentials for Conducting Compliance & Ethics Due Diligence

DANIEL R. HARPER, JD, CCEP

@DANHARPERJD

KASEY T. INGRAM, JD, CCEP

@KASEYINGRAMJD

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Today's Goals

- How to recognize the ethics and compliance risks and considerations that arise during mergers, acquisitions, and related transactions, such as joint ventures.
- How to mitigate deal-related ethics and compliance risks and considerations through due diligence, contract provisions, and strategic planning.
- How to integrate ethics and compliance after the deal to identify and mitigate any post-closing ethics & compliance risks.

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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 Criminal Division Evaluation of Corporate Compliance Programs April 2019 Guidance Document



“A well-designed compliance program should include comprehensive due diligence of any acquisition targets. Pre-M&A due diligence enables the acquiring company to evaluate more accurately each target’s value and negotiate for the costs of any corruption or misconduct to be borne by the target. Flawed or incomplete due diligence can allow misconduct to continue at the target company, causing resulting harm to a business’s profitability and reputation and risking civil and criminal liability.

The extent to which a company subjects its acquisition targets to appropriate scrutiny is indicative of whether its compliance program is, as implemented, able to effectively enforce its internal controls and remediate misconduct at all levels of the organization.”

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USDOJ Criminal Division Evaluation of Corporate Compliance Programs April 2019 Guidance Document (cont.)



“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?”

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A Framework for OFAC Compliance Commitments U.S. Dept. of Treasury – May 2019

“Mergers and Acquisitions (M&A): As noted above, proper risk assessments should include and encompass a variety of factors and data points for each organization. One of the multitude of areas organizations should include in their risk assessments—which, in recent years, appears to have presented numerous challenges with respect to OFAC sanctions—are mergers and acquisitions. Compliance functions should also be integrated into the merger, acquisition, and integration process. Whether in an advisory capacity or as a participant, the organization engages in appropriate due diligence to ensure that sanctions-related issues are identified, escalated to the relevant senior levels, addressed prior to the conclusion of any transaction, and incorporated into the organization’s risk assessment process. After an M&A transaction is completed, the organization’s Audit and Testing function will be critical to identifying any additional sanctions-related issues.”

https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf at 4-5

Seat at The Table

- How strong is your relationship with the Chief Strategy Officer/Head of M&A?
- Do you have insight/representation on any M&A Committees?
- What structures are in place to ensure the Compliance team is well apprised of any potential M&A activity?

Thoughts:

- Don’t get stuck being brought in at the last moment – it is impossible to effectively evaluate a target in a short time.
- “Seat at the table” requires the Compliance Professional to be proactive in ensuring that s/he knows what opportunities are being reviewed by the organization.

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.

PART I

Recognizing Risks

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.

Training

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

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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

Thoughts:

- Use already allocated resources to enhance your compliance work. For example, have the forensic accountants do FCPA testing; have HR resources review compensation plans for compliance concerns, etc. (Note – although you are always responsible for this, it is certainly acceptable to oversee others' work).
- Layering additional process simply for compliance purposes will make your job harder. Using already allocated structures and resources will help drive compliance into the organization's DNA.
- Make sure you have (or bring in) the right expertise to support your due diligence. For example, if you need language or cultural expertise for a particular geography, do not go without.

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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
- Third Party Risks
- Known Problems
- Potential Sources of Unknown Problems

PART II

Mitigating Risks

Issue Spotting

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

PRE-MERGER

- Finding the Problems
- Fixing the Problems
- Recommending Next Steps

Due Diligence Questionnaires

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

Sample Instructions

PURPOSE: During the due diligence phase of a merger or acquisition, this Questionnaire 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 Questionnaire. When the response requires additional documents, obtain those documents from the Company. Upon completion of the Questionnaire, send it to the Chief Compliance Officer, or any appropriate designee, for review. The Compliance team will review the Questionnaire and follow up with the Due Diligence team should any issues arise.

Sample Questionnaire



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.	

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Resolution

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

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PART III

Integration

POST-MERGER

- Integrating the New Entity
- Remediating Known Issues

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. In almost all situations, some post closing due diligence will be needed.

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 What You Do

Thoughts:

- Make sure post closing compliance activities are integrated into (and tracked with) organization's overall integration plan

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

Frequent communication through as many channels as possible via direct managers and with a strong emphasis on integrity will likely help reduce those compliance risks.

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Timing



- In Opinion Procedure Release 08-02, the US DOJ set forth aggressive integration and remediation timelines for Halliburton.
- In Opinion Procedure Release 14-02, the US DOJ stepped back from fixed timelines applicable to every deal:
 - "The Department expresses no view as to the adequacy or reasonableness of Requestor's integration of the Target Company. The circumstances of each corporate merger or acquisition are unique and require specifically tailored due diligence and integration processes. Hence, the exact timeline and appropriateness of particular aspects of Requestor's integration of the Target Company are not necessarily suitable to other situations."
- When setting timelines
 - Focus upon the specific nature of the transaction.
 - Tailor due diligence and integration processes to the specifics of the transaction.
 - Act as "quickly as practicable."

In Opinion Procedure Release 14-02, the US DOJ specifically referenced steps expected related to FCPA compliance:

"To be sure, the Department encourages companies engaging in mergers and acquisitions to (1) conduct thorough risk-based FCPA and anti-corruption due diligence; (2) implement the acquiring company's code of conduct and anti-corruption policies as quickly as practicable; (3) conduct FCPA and other relevant training for the acquired entity's directors and employees, as well as third-party agents and partners; (4) conduct an FCPA-specific audit of the acquired entity as quickly as practicable; and (5) disclose to the Department any corrupt payments discovered during the due diligence process. See FCPA Guide at 29. Adherence to these elements by Requestor may, among several other factors, determine whether and how the Department would seek to impose post-acquisition successor liability in case of a putative violation."

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Integration Plans

- Incorporate Compliance and Ethics plans into the organization's overall integration plan (HR, Finance, Legal, etc.) – You will be less likely to step on each other's toes.
- Plans needed for general compliance and ethics as well as appropriate substantive areas
- Plans 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 each element of the Plan and any known deficiencies

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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.

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Sample Integration Plans

1. GENERAL COMPLIANCE & ETHICS PROGRAM

	ACTION	TIMING
1.	Determine Compliance Officer(s) for Company	Within first 30 days
2.	Issue Code of Ethics to All Employees	Within first 30 days
3.	Issue Hotline information to All Employees	Within first 30 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 60 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 30 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
4.	Complete post closing forensic testing and due diligence	Within first 90 days

Remediation

- Guided by the Questionnaires
- Do not expect a miracle – be reasonable about time, but act “as quickly as practicable.”
- Document & Follow-up



Sample Attestation



ATTESTATION TO THE COMPLIANCE INTEGRATION CHECKLIST

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

Deficiencies

Plan to Resolve

Integration Manager

Date

Compliance Officer

Date

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Effective Integration Requires Balance



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

- When integrating two different cultures, soft skills can create a lasting impact.
- Get the Job Done BUT do not sacrifice a long-term impact to gain a short-term victory.



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Tools for a Positive Impact

- 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



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CULTURE – CULTURE - CULTURE

- Culture can make or break your compliance & ethics program.
- Culture change requires trust and acclimation.
- Don't layer Compliance – Build it in to the organization.
- You should only expect what you inspect.
- Brand your program – Use language that can/will become familiar to all
– for example "Always Do the Right Thing".



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If You Want to Succeed, You Need to Show Up

- Long-distance relationships are difficult.
- Planes, trains, and automobiles are essential communications tools.
- You won't really know what the culture is until you live it.
- Internal Networks are vital.



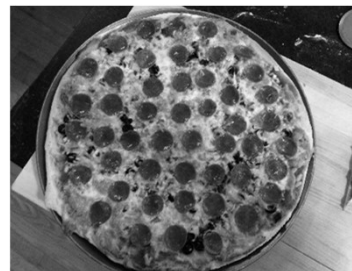
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GIVE IT AWAY

Use branded items to market the program



Use food to increase attendance

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Semper Gumby

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



PART IV

Other Considerations

What if My Company is the Target?

If your company is considering a sale or merger, or is potentially a target for a sale or merger, use the tools above to ensure that you can meet the due diligence demands of a potential acquirer.

- Identify Weaknesses in the Program
- Determine Mitigation Required, if any
- Speed up the Acquisition/Merger Process

What About Other Transactions?

The tools used for an acquisition can also be used any time you need to evaluate yours or another party's compliance program.

Examples:

- Joint Ventures
- Going Public/Getting Listed on an Exchange

Are there any Contractual Considerations?

Knowing the potential compliance risks can help you help Legal.

Examples:

- Requiring mitigation/resolution before deal required to close.
- If there is a trade sanctions risk, including a change in trade sanctions as a reason to terminate the transaction.
- Reps & Warranties that all material information provided, therefore later discovered information constitutes reason to terminate transaction.

Parting Thoughts

- Know What You're Buying.
- Documentation is key to an effective defense should something go wrong.
- Be flexible where you can and firm where you have to be.
- If you're not there, it appears you don't care.
- Communication is key – can't resolve an issue until it is known.
- Use these tools any time that you need to evaluate how a third party may view yours or another's compliance program.
- Help your organization go into M&A with its EYES WIDE OPENED!



QUESTIONS?

Daniel R. Harper
General Counsel & Compliance Officer
GEA Farm Technologies, Inc.
@DanHarperJD
<https://www.linkedin.com/in/danharperlegal/>

Kasey T. Ingram
General Counsel & Chief Compliance Officer
ISK Americas Incorporated
@KaseyIngramJD
<https://www.linkedin.com/in/kaseyingram/>