What Can Go Right (and Wrong) with Third-Party Due Diligence?

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Entity Due Diligence and Monitoring
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About Pacific Gas and Electric

Pacific Gas and Electric Company, incorporated in California in 1905, is one of the largest combined natural gas and electric energy companies in the United States.

PG&E provides natural gas and electricity to most of the northern two-thirds of California.

PG&E provides services to 5.2 million households, representing approximately 16 million people throughout a 70,000-square-mile service area in northern and central California.
About Lexis Nexis

A leading global provider of legal, regulatory and business information and analytics that help professional customers make more informed decisions, increase productivity and serve their clients better.

LexisNexis Legal & Professional, which serves customers in more than 130 countries with 10,600 employees worldwide, is part of RELX Group, a world-leading provider of information and analytics for professional and business customers across industries.
What can go right (and wrong) with third-party due diligence?

Studies show that almost *two thirds* of the due diligence procedures were graded as *inadequate*.

~ Anne Fleur Goedegebuure
Consultant, GoodCorporation
Third-Party Due Diligence

Of the seven FCPA cases through the first half of 2018, due diligence, or lack thereof, was a specific reference in five:

• ...no evidence to suggest that Plaza conducted any due diligence...

• ...Kinross contracted with a politically-well-connected third-party consultant to facilitate contacts with high-level government officials w/o conducting the heightened due diligence required by the company’s policies and procedures...

• ...PAC [Panasonic Avionics Corporation] recommended, but did not require, third-party due diligence...

• ...Societe Generale's engagement of the Panamanian Company, including repeating the false representation that the Panamanian Company...

• ...Legg Mason did not timely institute appropriate risk-based due diligence...

~ Scott Shaffer is the Managing Director for the Kreller Group
What can go right (and wrong) with third-party due diligence?

- Stumbling Blocks to Third-Party Due Diligence
  - Prioritizing Third Parties
  - Obtaining Reliable Data
  - Dealing With Red Flags
Prioritizing Third Parties

• All third parties?
• Greatest Threats
• Key High-Risk Third Parties
  • Sales Agents
  • Intermediaries
  • JV Partners
  • Those with Permits and Licenses
• Low-Risk Third Parties
  • General Suppliers
  • Low Spend
  • Low Criticality
A Short History of Supplier Risk

Multiple Streams of Supplier Risk Review

- Iterative per contract review upon processing requisition or resulting from an RFP
- Annual review of vendors identified as “High Risk”
- New program combining the two activities with contract review of key PESTLE metrics (Financial, Legal, Operational, Reputation, Environmental, Cyber)
Prioritizing Third Parties
“Segmentation”

<table>
<thead>
<tr>
<th>Risk Area</th>
<th>Risk Sub Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>• Financial Impact</td>
</tr>
<tr>
<td></td>
<td>• Supplier Viability</td>
</tr>
<tr>
<td>Operational</td>
<td>• Business Continuity</td>
</tr>
<tr>
<td></td>
<td>• Supplier Market (# of qualified suppliers)</td>
</tr>
<tr>
<td></td>
<td>• High Risk Activities (Loss of Power, Loss of Life, environmental degradation and other sustainability concerns)</td>
</tr>
<tr>
<td>Reputational &amp; Regulatory</td>
<td>• Supplier Location</td>
</tr>
<tr>
<td></td>
<td>• Regulatory Implications</td>
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<tr>
<td></td>
<td>• Reputational Impact</td>
</tr>
<tr>
<td></td>
<td>• Lack of diversity</td>
</tr>
<tr>
<td>Information and Cyber Security</td>
<td>• Systems Access (Physical &amp; Remote)</td>
</tr>
<tr>
<td></td>
<td>• Access to Confidential/Sensitive Information</td>
</tr>
<tr>
<td></td>
<td>• Responsibility for managing records (maintained for legal/regulatory reasons)</td>
</tr>
</tbody>
</table>
Obtaining Reliable Data

- Questionnaires
  - Business Partner's Ownership
  - Management Structure
  - Policies
  - Mitigating Measures and Controls
  - Subcontracting
  - Legal/Regulatory Matters
- References
  - Validation
  - Onsite Visit
  - In-Country Investigations
Obtaining Reliable Data

There are many sources to be utilized.

• Questionnaires: external and internal
• Financial Data
• News Aggregation
• Contractor Safety
• Excavation Certification
• Internal Financial review
• Cyber review
Dealing with Red Flags

- Threshold of Acceptability
  - Non-Standard Remuneration Arrangements
  - PEP
  - Conflicts of Interest
- Prohibitive
  - Mitigation Measures
  - Contractual Clauses
  - Audit Rights
  - Enhanced Breach Rights
  - Policies and Training
- Monitoring and Documentation
Dealing with Red Flags

- Review
- Validate
- Mitigate/Manage
- Off-board
Challenges to Third-Party Due Diligence

• Proper due diligence takes time and money.

• Determining the proper level of due diligence, given the situation.

• There is no due diligence program that can perfectly address every possible scenario.

• Due diligence is critical, but must be supplemented with other compliance initiatives and internal controls.
Lessons Learned for Third-Party Due Diligence

• Due diligence: “nice to have” vs. “must have.”

• Basic due diligence is not sufficient for high risk engagements.

• Due diligence may not prevent the issue, but, at a minimum, should alert of possible red flags or risk in the engagement.

• The DOJ and SEC consider due diligence (or lack thereof) when reviewing cases and determining punishments.

• Proper due diligence is a fundamental step in a well-structured compliance program.
Questions and Answers
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Thank you for your attendance!
Meet the Speaker

Jon Levin has over 20 years of experience in directing program-level initiatives and leading operations, programs, and day-to-day activities. His current responsibilities are management of Contractor Safety and Supplier Risk Programs within Supply Chain. He has a keen understanding of the logistics and process methodologies supporting roles of leadership. He has experience in evaluating potential inherent risk exposure, existing controls, and mitigation plans to address identified potential risk.

He is currently a Senior Program Manager with PG&E. In this role, he is focused on establishing an environment of continuous improvement, including adopting review and refinement as part of the process. He is constantly learning and continues to study for the betterment of process and approach. Jon completed his Bachelor of Arts degree in Interdisciplinary Studies with a minor in Critical Psychology at the California Institute of Integral Studies in San Francisco.
Meet the Speaker

Karen E. Gray is a 24 year LexisNexis veteran and a Senior Supply Management Specialist for North America. Karen serves as LexisNexis' expert and central point person for all Supply Management solutions. She is a resource for Benchmarking, Market Intelligence, Strategic Category Management, and Vendor Selection, and focuses on efforts to improve profitability and cash flow, risk mitigation and operational efficiencies is the area of vendor selection and monitoring.

Karen facilitates Certificate of Mastery Programs for the F1000 and implements practical applications with leading-edge consulting and high-quality instruction. She applies the industry-standard PESTLE analysis framework to risk assessment in order to anticipate and manage risk more effectively within any third-party portfolio. Karen serves as a team lead for Supply Management Consultants and on the SIG Resource Center Thought Leadership Council.
Presenters

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