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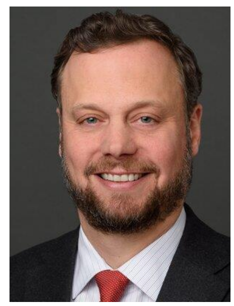
Avoiding Bribery, Corruption And Sanctions Risks In Int'l M&A

By **Brian Markley and Jennifer Potts** (October 25, 2023, 1:22 PM EDT)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The U.S. Department of Justice announced a departmentwide mergers and acquisitions safe harbor policy on Oct. 4, addressing target-company misconduct discovered by an acquirer during its due diligence process.

The policy will give acquirers the presumption of a declination — i.e., a formal decision not to prosecute — if they disclose, within six months of closing, illegal activity identified at the acquired company, and remediate that misconduct within one year.

This new policy highlights again the importance of conducting robust preacquisition diligence and post-closing risk assessments. This is especially true for deals with international touchpoints presenting heightened risks for anti-bribery and corruption, and trade sanctions, violations, which is the subject of this article.

Due diligence aimed at anti-bribery, corruption and sanctions risk will sometimes identify evidence of actual misconduct, informing decisions to adjust a purchase price, strengthen contractual provisions, alter a transaction perimeter or even walk away from a deal, depending on the findings.

But even where no actual misconduct is identified, effective diligence can identify compliance gaps and weaknesses, such as inadequate due diligence of third-party intermediaries, excessive gifts and entertainment, questionable charitable contributions and political donations, and other red flags.

Identifying and remediating these issues promptly upon closing will help mitigate ongoing legal exposure for both the newly acquired company and the acquirer itself.

Due Diligence Risks for Acquirers: Recent Case Studies

A steady drumbeat of enforcement actions and statements by regulators have highlighted both the benefits of conducting robust diligence, and also the consequences of failing to identify potential risks.

In May, for example, U.S. cosmetic company Murad LLC entered into a $3.3 million settlement with the Office of Foreign Assets Control over alleged sanctions violations arising out of its sale of products into Iran.[1]

Murad voluntarily disclosed the violations several years after it was acquired by Unilever US, which reportedly had been unaware of the misconduct before and for some time after its acquisition, even though Murad maintained an active "Murad.ir" website — the country domain for Iran.

Unilever itself was not ultimately charged, but was of course subject to indirect economic consequences, since its wholly-owned subsidiary paid a substantial fine,, as well as reputational harm.

In contrast, on the anti-bribery and corruption front, French aircraft equipment manufacturer Safran SA avoided prosecution last year under the Foreign Corrupt Practices Act following its voluntary self-disclosure involving improper payments made by two acquired subsidiaries identified by Safran during a risk assessment after the transaction closed.

In that case, the DOJ declined to prosecute, though the company agreed to disgorge approximately $17 million in profits generated from the alleged activities.[2]

This resolution offered a preview of the now formalized DOJ policy allowing for the presumption of a declination for acquirers that uncover, self-report and remediate misconduct identified during due diligence or shortly thereafter.

Practical Considerations

Against this backdrop, how should companies prepare to conduct diligence on high-risk transactions?

As a starting point, they should conduct an initial baseline assessment to help determine the appropriate scale and scope of their diligence plan.

Information easily ascertainable at the outset of the diligence process should be considered, including the relative anti-bribery, corruption and sanctions risk of (1) the countries where the target operates; (2) the nature of the target's business and overall industry; and (3) the likelihood of interactions between the target and government agencies, e.g., for ongoing licensing and permitting, inspections, and commercial dealings with public officials and agencies.

The results of this initial assessment can be helpful in informing the scope of enhanced due diligence review, permitting acquirers to tailor their procedures and apply a risk-based approach.

A thorough, well-informed plan also allows acquirers to demonstrate, in the event of future scrutiny, that they approach each opportunity with eyes wide open, in a manner consistent with best practices.

Acquirers should be mindful that if diligence projects are conducted at the direction of counsel, they may be able to take advantage of attorney work-product protections and the attorney-client privilege to avoid compelled production of work papers, communications and findings, at least in connection with U.S. litigation and regulatory inquiries, where applicable.

Anti-Bribery, Corruption and Sanctions Due Diligence Process

While each transaction is different and warrants varying levels of diligence, recommended baseline anti-bribery, corruption and sanctions due diligence practices for acquisitions or other significant investments may include the following.

Background Checks

First, acquirers should conduct background checks of adverse media, sanctions lists, litigation searches and other biographical background information on the seller, the target, key individuals and third parties.

The depth of these background checks should depend on the inherent risk of a transaction and whether any specific issues and red flags have been identified.

For many transactions, a desktop review of publicly available sources of information may be appropriate, but higher-risk transactions with particularly sensitive issues may warrant a more bespoke, boots-on-the-ground approach, including discreet conversations on a no-name basis with local market and industry sources and a review of hard-to-find records, such as filings maintained only by local government departments and agencies.

Target Company's Internal Programs

To reduce merger and acquisition risk, buy-side companies must also assess the target's internal anti-bribery, corruption and sanctions compliance program by reviewing relevant documents and information, such as policies and procedures, employee training program documents, complaints received through internal reporting channels, and internal controls procedures.

Obtaining detailed information about the target's compliance program is helpful to understand the breadth of the program and if there are gaps or areas for enhancement.

It is important for acquirers and their counsel to look beyond the superficial in this regard and to assess whether such programs have been properly implemented in the target's organization, as opposed to serving merely as window dressing.

Information about compliance-related complaints not only provides details of any specific issues encountered by the target, but also a view into whether the compliance program is working as designed — i.e., if internal reporting channels have been well publicized, companies and counsel should typically expect to see a critical mass of reports, even if some are unfounded or trivial.

In that regard, a lack of any reports can be a red flag.

Interviews

Due diligence processes will likely include interviews of the target's key personnel and executive team, along with line-level personnel likely to interact with government officials or oversee high-risk third parties.

These interviews should be tailored for each transaction and interviewee, and the plan should be flexible, allowing for adjustment if new information is identified.

Ideally, personnel should be interviewed individually to help ensure robust and independent answers, and to avoid group think and chilling effects.

In some transactions, a handful of interviews may suffice, whereas higher-risk deals may warrant dozens of interviews across a target company.

It can sometimes be helpful to include forensic auditors in these interviews, particularly for accounting-related issues, and they may also provide translation services as needed.

Forensic Transaction Testing

Recommended best practices also include forensic transaction testing of a risk-based sample of payments by the target, e.g., gifts and entertainment, consultant fees, charitable contributions, and the like.

These transactions can typically be identified from the target's accounting ledgers and accounts payable information.

In most cases, the forensic team — typically acting at the direction of counsel — requests supporting documentation for each of the sample transactions, such as contracts, invoices, receipts and proof of services rendered, and then reviews such documentation not only for evidence of misconduct, but also to determine whether the target adheres to its own policies, procedures and controls, and properly records the payments consistent with best practices.

This process requires cooperation from the seller and target and is often iterative, requiring multiple rounds of follow-up requests and clarifications.

Forensic transaction testing of this nature is not a good fit for every transaction, especially in fast-moving auction or hostile bid situations, where seller cooperation can be at a premium. But when available, it can add tremendous value to a diligence work stream.

Due Diligence Report

As noted, acquirers and their counsel should be prepared to be nimble in the due diligence process, adjusting their work plan and focus areas as needed during the course of diligence.

Often, what was expected to be a straightforward diligence process will evolve considerably once a corruption-related allegation or other red flag, such as a high-risk or low-profile intermediary, is identified.

At the end of the due diligence process, counsel will typically prepare a privileged report that is protected by the attorney work-product doctrine and identifies (1) the scope and metrics of the analysis, i.e., what was reviewed, who was interviewed, etc.; (2) key findings of fact; (3) an analysis of applicable law, including potential successor liability; (4) recommended contractual protections to be included in transaction documents; and (5) perhaps most importantly, proposed compliance program enhancements and other remedial measures to address risks associated with potential ongoing misconduct after closing.

Post-Acquisition Integration

Compliance enhancements should be implemented at newly acquired companies as quickly as possible.

As a general rule, U.S. issuers and domestic concerns — unless they take advantage of the new safe harbor policy referenced above — may face exposure on day one for ongoing misconduct, even if the target was not previously subject to applicable anti-bribery, corruption and sanctions laws.

Recommended baseline post-acquisition integration practices should be informed by the acquirer's preacquisition diligence, and typically may include:

- Remediating compliance program gaps and weaknesses and taking related corrective actions, including immediate action to stop any misconduct identified during due diligence on closing, if not before closing, if possible;

- Implementing a compliance program and internal controls at the acquired company, commensurate with acquirer's own compliance program and internal controls, and the standards articulated by the DOJ in its evaluation of corporate compliance programs guidance and the Treasury Department's framework for OFAC compliance commitments;[3]

- Training the employees of the acquired company on FCPA and sanctions requirements and the acquirer's compliance program and policies, which, for cross-border transactions, may involve translating training materials and policies and procedures into local languages, with consideration of local cultural nuances, as well; and

- Conducting post-acquisition anti-bribery, corruption and sanctions risk assessments of the acquired company to identify additional necessary and ongoing compliance efforts, which is particularly important in transactions where preacquisition due diligence or access to company information was limited — for example, in an auction or hostile takeover situation.

Conclusion

For M&A transactions with international touchpoints, consideration of anti-bribery, corruption and sanctions risks should be built squarely into an acquirer's due diligence process.

This can identify misconduct, providing companies an opportunity to take advantage of the DOJ's new safe harbor, and also shine light on compliance weaknesses requiring remediation to avoid ongoing violations.

Failure to adequately assess these risks can lead to regulatory scrutiny, investigations, fines and reputational harm, along with reduced return of investment.

As the M&A landscape continues to evolve and investment opportunities shift, it will be even more important than ever for potential acquirers to be armed with as much information as possible to identify and address risks and avoid unnecessary distraction and exposure in the post-acquisition period when transactions move forward.

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[1] See https://ofac.treasury.gov/media/931766/download?inline.

[2] See https://www.justice.gov/criminal-fraud/file/1559236/download.

[3] See https://www.justice.gov/criminal-fraud/page/file/937501/download; https://ofac.treasury.gov/media/16331/download?inline.