Anti-corruption Due Diligence: A Key Component of Mergers and Acquisitions

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The increasing focus on enforcement of the US Foreign Corrupt Practices Act (FCPA), Canadian Corruption of Foreign Public Officials Act and UK Bribery Act, as well as similar anti-corruption laws around the globe, has made conducting pre-acquisition anti-corruption due diligence an essential element of any cross-border merger or acquisition, especially if the target does business in a jurisdiction where local officials may expect to be compensated for simply doing their job. Although some may view their payments to "government officials" (the definition of which is very broad) as merely a cost of doing business or a necessary evil to expedite the granting of a license or permit, in addition to running afoul of applicable laws such payments can wreak havoc with an open and accurate economic analysis of the true costs of doing business, particularly since they tend not to be readily apparent in financial statements relied upon by buyers and lenders worldwide.

As a result, the failure to conduct pre-acquisition anticorruption due diligence can lead to severe legal and financial consequences, as well as reputational damage, for both buyers and sellers. For buyers, anti-corruption diligence can be especially critical because, under US principles of successor liability, a buyer may be held liable for pre-closing FCPA violations by the target. And if illegal conduct by the acquired company continues post-closing, the buyer can be held directly liable, even if it had no knowledge of or participation in the violation. For sellers, putting aside any individual liability (which would survive a transfer of ownership or control), concerns about potential pre-closing violations can strongly influence a deal's value, if not threaten the entire transaction. Moreover, sellers may be asked to provide specific representations—or even fundamental representations—and warranties as to anti-corruption compliance that are backed by broad indemnification provisions and hefty escrow amounts.

The two US government agencies responsible for enforcing the FCPA, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), have endorsed a risk-based approach to conducting preacquisition anti-corruption due diligence. As explained in greater detail below, such an approach requires an initial evaluation of the target's risk profile, followed by the creation and subsequent implementation of a work plan that incorporates review procedures specifically tailored to and commensurate with the risks identified. Even if pre-acquisition anti-corruption diligence does not reveal evidence of bribery (after all, the professionals conducting the exercise lack badges and subpoena power, and must to some extent rely on the target's personnel to provide accurate and complete information), conducting such a review can help to identify "red flag" indicators of corruption and potential control weaknesses. Once armed with that information, a prospective buyer can address the issues with the seller and, ideally, convince the seller to remediate and voluntarily report any violations to the relevant authorities before the deal is closed. At a minimum, the results of the review can be factored into the deal terms and pricing, as well as taken into consideration by the buyer when designing plans to integrate the target into its operations. The exercise could also prove useful in demonstrating to law enforcement the buyer's commitment to anti-corruption compliance, should violations come to the government's attention postclosing. Stated another way, if you do not devote sufficient time and resources to try to detect corrupt practices pre-closing, arguments that you were an "innocent purchaser" may fall on deaf ears.

The important role of pre-acquisition FCPA due diligence

In their November 2012 Resource Guide to the FCPA, the DOJ and SEC caution that in the M&A context, they may pursue FCPA charges utilizing theories of successor liability as well as direct liability.1 Successor liability means that a buyer can be held liable for pre-closing violations committed by the target company (or its agents), so long as the target was subject to FCPA jurisdiction at the time of the conduct. Notably, if a target was not subject to the FCPA pre-transaction, the mere fact of the acquisition will not create successor liability. On a direct liability theory, the DOJ and/or the SEC could pursue FCPA charges against a buyer for any post-closing FCPA violations committed by the acquired company (or its agents).

In light of this legal framework, the DOJ and SEC "encourage companies to conduct pre-acquisition due diligence[,]" as well as to enhance compliance programs and internal controls post-acquisition. As described in the Resource Guide, conducting pre-acquisition FCPA diligence can provide a range of benefits to both buyers and sellers, including:

- Enabling buyers to more accurately value the target company
- Laying the foundation for a buyer to rapidly and successfully integrate the target company into its operations post-closing, including by reducing the risk that the target company, once acquired, will continue to engage in any conduct that violates the FCPA
- Allowing the parties to handle any potential FCPA violations uncovered by the diligence in a more orderly and efficient manner
- Demonstrating a genuine commitment to identifying and preventing FCPA violations

The DOJ and SEC also note that pre-acquisition due diligence can be a crucial mitigating factor in their decisions on whether to bring an FCPA enforcement action and, should they nonetheless decide to proceed, it will factor into the calculation of any penalty that may be imposed. According to US regulators, "[i]n a significant number of instances, DOJ and SEC have declined to take action against companies that voluntarily disclosed and remediated conduct and cooperated with DOJ and SEC in the merger and acquisition context." Moreover, they note that "DOJ and SEC have only taken action against successor companies in limited circumstances, generally in cases involving egregious and sustained violations or where the successor company directly participated in the violations or failed to stop the misconduct from continuing after the acquisition."

Tips for conducting risk-based anti-corruption due diligence

Pre-acquisition anti-corruption diligence procedures should be aligned with the particular risk profile of the potential acquisition target. In the Resource Guide, the DOJ and SEC advise that "the degree of appropriate [FCPA] due diligence may vary based on industry, country, size and nature of the transaction[,]" and recommend a "thorough risk-based" approach when determining how to allocate pre-acquisition diligence resources.

A potential buyer (or a potential seller who wishes to conduct a compliance assessment in advance of marketing the company, particularly to US buyers) should consider the following non-exhaustive list of risk factors:

- **Geography**: the perceived corruption risk of each jurisdiction in which the target or its subsidiaries or affiliates operates, either directly or through third parties (e.g., countries with low scores on the Transparency International Corruption Perceptions Index, which is a widely recognized barometer for corruption risk based on information from independent institutions that specialize in the analysis of governance and business climates)
- **Industry**: the perceived corruption risk of the industry or sector in which the target does business, particularly industries that have been the focus of heavy anticorruption enforcement, such as oil and gas, medical devices, pharmaceuticals and freight forwarding
- **Government business**: the extent to which the target's revenues rely on government contracts and/or government concessions, including licensure, permits or other authorizations
- **Government interactions**: the target's level of interaction with government officials, including the importance of licenses and permits to its operations, the degree of government oversight and inspection and the significance of goods and personnel clearing customs and immigration
- **Business development and sales strategy**: the target's business development program, including any travel, gifts or entertainment provided or received
- **Third-party intermediaries**: the target's reliance on thirdparty agents, particularly in dealing with government officials (including officers or employees of state-owned enterprises) or for business development efforts
- **M&A activity and JV arrangements**: the appropriateness of the target's diligence in connection with mergers, acquisitions and joint ventures
- **Compliance program**: whether the target has adopted and implemented anti-corruption policies and procedures, and if so, whether the anti-corruption program is adequate for the risks presented
- **History**: the target's compliance history, including allegations or suspicions of corruption

Informed by an assessment of the target's risk profile, a pre-acquisition anti-corruption due diligence plan should be tailored to the transaction and then implemented. Typically, but not always, anti-corruption diligence can be performed alongside standard commercial due diligence, using many of the same materials and methods for obtaining information. For example, anti-corruption diligence procedures might leverage an electronic or physical data room, financial analyses already prepared for other purposes, opportunities to interview key personnel and certain publicly available information about the target, its owners and/or key personnel. Throughout the process, anti-corruption diligence should be focused on identifying "red flags" requiring heightened scrutiny and follow-up procedures, possibly including expanded requests for information or data.

To enhance the effectiveness and efficiency of anticorruption diligence, it is often helpful to integrate US counsel experienced in this area with local counsel in the relevant jurisdictions. This allows the review to incorporate local laws and practices, for example "customary" per diem payments to traveling government regulators or the provision of hospitality to potential customers. Similarly, integrating US and local counsel can help ensure that diligence procedures are targeted to higher-risk areas and nomenclature, such as by focusing on relevant local language search terms (e.g., chaqian ["tea money"] in Chinese; pod stolom ["under the table"] in Slovak).

Conclusion

Given the regulators' ongoing focus on compliance with global anti-corruption legislation, conducting targeted anti-corruption due diligence is increasingly critical for any cross-border corporate transaction, particularly those involving US companies or US nationals doing business outside the US. Ideally, implementing the type of riskbased review suggested by the DOJ and SEC will uncover any evidence of corruption before a deal is inked, but even if it does not, the exercise can provide a range of significant benefits, not the least of which is identifying "red flags" and other weaknesses that can be addressed in the deal documents and incorporated into the buyer's integration plans so that any questionable practices cease prior to closing.

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