FCPA Considerations in M&A Transactions

MAY 14, 2014

Below is an excerpt from WilmerHale's 2014 M&A Report, which was released on May 6, 2014. This excerpt summarizes the FCPA risks for purchasers and sellers in M&A transactions and suggests affirmative steps companies can take to manage those risks both pre- and post-closing. View the full report or request a hard copy.

The Foreign Corrupt Practices Act (FCPA) is a criminal and securities statute that is jointly enforced by the Department of Justice (DOJ) and the SEC. The FCPA has two components:

- The statute prohibits any company whether private or public, as well as its officers, directors, employees, stockholders and agents, from making or offering corrupt payments to foreign government officials.
- The statute requires every public company to maintain accurate books and records and to implement adequate internal accounting controls. This requirement is in addition to the internal control requirements imposed by the Sarbanes-Oxley Act.

Investigations and enforcement proceedings under the FCPA have been instituted in record numbers over the past several years, resulting in the payment of hundreds of millions of dollars in fines and penalties. Many of these proceedings have arisen in the M&A context. Companies engaged in acquisition activity should understand the risks posed by FCPA violations and the steps that can be taken to reduce those risks.

US enforcement authorities have made clear their expectation that purchasers of transnational businesses will conduct pre-acquisition FCPA due diligence and will, post-closing, promptly implement appropriate FCPA remediation and compliance integration steps. The joint FCPA guidance issued in 2012 by the DOJ and SEC describes pre-acquisition due diligence and post-acquisition integration as among the hallmarks of an effective compliance program. More recently, the now-former leader of the DOJ's FCPA unit explained that the nature and quality of pre-acquisition diligence is one of the most critical factors that the DOJ considers when making a charging decision in the M&A context. These pronouncements by enforcement agencies, coupled with the results of recent enforcement proceedings, underscore the need for both purchasers and sellers to evaluate FCPA risks and pursue related risk mitigation strategies when undertaking transactions.

The FCPA risks for purchasers in M&A transactions generally are threefold, any of which may expose the purchaser to greater regulatory scrutiny or hurt its stock price:

- *Legal Risks:* A purchaser may acquire legacy as well as prospective legal liability, depending on the circumstances of the acquisition. For example, a purchaser who fails to detect ongoing bribery by the target may inherit the legacy liability of the target for past misconduct, as well as incurring liability for misconduct after the purchase, when the purchaser is responsible for the target's compliance with the FCPA.
- *Financial Risks:* A target may not be properly valued if FCPA issues are not identified. For example, a purchaser may discover after the closing that it faces civil and criminal financial penalties, the loss of government contracts that have been obtained through corrupt conduct, or the need to terminate the employment of key personnel who have been involved in misconduct.
- *Reputational Risks:* Misconduct by a target may tarnish a purchaser's compliance record.

To manage these risks, purchasers in M&A transactions should take affirmative steps to address FCPA issues both pre- and post-closing. While there may be impediments to conducting extensive diligence in some types of transactions (such as auctions or hostile takeovers), purchasers should resist pressures to "get the deal done" without adequate diligence appropriate to the risks of the transaction. The key steps purchasers should take include the following:

- *Due Diligence:* Before entering into an acquisition agreement, the purchaser should develop a profile of the target in five areas: the target's industry and business operations, including its interactions with government officials; the target's past business practices; the target's corporate structure, subsidiaries and joint ventures; the target's relationships with its third-party business partners, such as agents, consultants and distributors; and the target's anti-corruption compliance program. Depending on the level of anti-corruption risk that results from this profile, the depth of follow-up diligence may vary. Typically, at a minimum, informational interviews with key employees of the target and a review of basic documentation should be undertaken. If the anti-corruption risk appears higher, site visits, forensic transaction review, detailed interviews of employees of the target and interviews with the target's third-party representatives may be warranted.
- *Transaction Documents:* The negotiation of acquisition documents also provides the purchaser with an opportunity to mitigate FCPA risk from the transaction. If diligence has revealed (or the purchaser suspects diligence will reveal) potential FCPA liability, the purchaser should consider provisions such as: representations that the target has not engaged in corrupt conduct; a closing condition that the purchaser shall have completed FCPA diligence to the purchaser's satisfaction; indemnities from the seller for FCPA penalties and investigation costs; and provisions governing the joint investigation and perhaps disclosure of potential FCPA liabilities to the government.
- *Post-Closing Actions:* Once the purchaser assumes control of the target, the purchaser should quickly ensure that: FCPA issues identified in due diligence are fully addressed; improper conduct detected through diligence is stopped; appropriate remediation steps are implemented; and an effective compliance program is instituted at the target, including

training of the target's staff.

Sellers also face FCPA-related risks in M&A transactions. A purchaser's FCPA due diligence may uncover questionable payments or call into question the adequacy of the seller's internal controls. Purchasers may wish to disclose FCPA issues to the DOJ and SEC, even before an acquisition is completed, potentially leading to government investigation of and enforcement proceedings against the seller. These factors could affect whether the transaction can be consummated and, if so, on what terms. In addition, sellers face potential risks if their FCPA representations and warranties are inaccurate. As a result, sellers should consider conducting their own due diligence prior to embarking on an M&A transaction, in order to ensure that their representations and warranties to the purchaser are accurate, as well as to anticipate potential FCPA enforcement issues.

Authors

Jay Holtmeier

PARTNER

jay.holtmeier@wilmerhale.com

+1 212 295 6413

Kimberly A. Parker

PARTNER

Vice Chair, Litigation/Controversy Department

Co-Chair, White Collar Defense and Investigations Practice

kimberly.parker@wilmerhale.com

+1 202 663 6987

Erin G.H. Sloane

PARTNER

erin.sloane@wilmerhale.com

+1 212 295 6458

Emily L. Stark

COUNSEL

emily.stark@wilmerhale.com

+1 202 663 6237

Roger M. Witten

SENIOR COUNSEL

roger.witten@wilmerhale.com

+1 212 230 8850