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MERGERS & ACQUISITIONS

Managing M&A Anti-Corruption Risk: Pre-Deal Prep

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The Anti-Corruption Report

The dry, clinical lingo used to describe compliance and anti-corruption tasks associated with mergers and acquisitions – "pre-acquisition due diligence," "negotiation of representations and warranties" and "post-acquisition integration and diligence" – belies the enormous pressure to get a deal done quickly and to avoid a worst-case scenario in which a company unwittingly buys some very expensive FCPA liability. One need only look to a few of the FCPA settlements reached in the last year or so to appreciate the vital need for candid and accurate compliance and anti-corruption counsel before, during and after a deal. Consider, for example, Kinross Gold's problems with subsidiaries in Mauritania and Ghana, Beam Suntory's issues with subsidiaries in India, Alere's acquisition by Abbott and Linde's acquisition of New Jersey-based company Spectra Gases Inc.

In this three-part series, The Anti-Corruption Report addresses M&A-related compliance and anti-corruption concerns from start to finish. This first article covers the greatest M&A-related FCPA compliance challenges, whether companies should have a written policy about anti-corruption risks relating to M&A, who should be on the deal team and what a company should be doing proactively to prepare for a merger or acquisition. The second article discusses a compliance team's responsibilities during the pre-acquisition diligence process, what to do if information is not forthcoming and how to react if problems are uncovered. The final article will take a close look at the possible terms of a transaction, when to walk away from a deal and what to do after closing.

Preemptive Preparation for a Deal

Whether a company will be an acquiror or an acquiree, it should take steps to prepare for anticipated M&A activity. Much as a seller interested in unloading a house would spruce it up to make the best possible deal, so, too, should a company seeking to be acquired.

Sell Side

Before transactions on the sell side, sellers are well-advised to put a compliance program in place if they operate in a higher-risk market and do not already have one, said Kristin Rivera, a global forensics leader at PwC. "It is not unlike selling your home," she continued. "Do not wait until you want to sell to plaster over cracks in the foundation and hope no one notices them. Instead, do the work that is necessary to fix the problem," she said.

William Olsen, a principal at Grant Thornton, agreed. "Companies need to be prepared to provide all of the information that would be necessary to get through the due diligence process quickly to satisfy those doing the due diligence that there is nothing to be concerned with," he observed. The process will proceed "much more smoothly if the organization being acquired is ready to answer the typical questions that arise and provide the documentation that typically is requested," Olsen noted.

"Before a company goes through the due diligence process with third parties coming in to do their review, the company may want to do its own internal dry run to identify any particular problems," he added. It may find it needs some remediation, and it may "need to take some steps to improve its own internal policies before going through a merger or acquisition," Olsen explained.

Buy Side

Buyers, even sophisticated ones, also may need to make sure their risk assessment and due diligence capabilities will be up to the task.

"Some companies approach deals with a certain risk tolerance," Rivera said. "They enter negotiations with their eyes open, knowing they are willing to accept a certain amount of risk because they are confident they can deal with it, and they price that into their offer," she explained.

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It helps if the buyer's deal team appreciates ABAC concerns. "It is really important internally to make sure that the people working on the deal understand the purpose of anti-corruption diligence and why it matters and why we need to do it," said Rebecca Rohr, vice president of anti-corruption and global trade in the ethics and compliance office at Hewlett Packard Enterprise.

See "Digging Deep Into M&A Anti-Corruption Due Diligence Best Practices: An Interview With William Michael, Partner at Mayer Brown LLP" (May 29, 2013).

The Value of an M&A Anti-Corruption Policy

Despite the inherent risk in any given transaction, companies seem to take varied approaches to whether to develop a written policy on M&A due diligence. "Whether a company should have a written policy about anti-corruption risks relating to M&A depends on the size of the company and how active the company is in making investments or engaging in M&A activity," explained Erin Sloane, a partner at WilmerHale.

Basic Policies

Some companies that do have such policies tend to keep them fairly general. "Most public companies and really good private companies will have an anti-corruption policy that includes provisions for M&A compliance due diligence," Sharie Brown, a partner at Troutman Sanders, reported. These policies "will not dictate what type of due diligence is required, but they normally recognize that the company wants to avoid inheriting a law enforcement action or writing off assets or liabilities when acquiring a company," she continued.

Instead of prescriptive policies, responsible companies "have a feature of their anti-corruption compliance program that includes a requirement for reasonable and appropriate M&A due diligence," Brown said.

Detailed Guidance

Some organizations, however, have developed more detailed policies on anti-corruption risks relating to M&A. A standing policy "does not have to be pages and pages long, but it ought to assign responsibility and set out the basic steps that a company will take," said Philip Urofsky, a partner at Shearman & Sterling who was writing a policy about anti-corruption risks relating to M&A at the time The Anti-Corruption Report interviewed him. Altogether, the policy will be about three pages in length and will specify that a due diligence team will perform risk assessments. "Depending on what the risk levels are, the team will do A, B and C," Urofsky explained. "Attached to the policy will be an example of a questionnaire and of contractual clauses" to include in the merger or share purchase agreement, he continued.

When an M&A team "sits down to do an acquisition, it should have that policy in mind," Urofsky said. Even so, what transpires will, of necessity, be situation-specific. "What the acquiring company will actually do, the people who will be appointed to the team, the questions the team will really ask and how much effort overall will be put into diligence will depend" on the nature of the transaction, Urofsky said.

Focusing on Procedures

Still other companies prefer to focus more on procedure than on a policy itself when it comes to M&A due diligence. Companies might develop handbooks or toolkits that "tend to be procedure-heavy and include checklists and forms that help the business implement compliance requirements around deal activity," Sloane said.

The first part of a handbook would typically include "a risk matrix where the business can say, 'I have these three factors, but not these six factors in this transaction,' and it can then turn to page eight and find the four things it needs to do given the risk factors present," Sloane explained. Risk factors include "the level of investment, the level of international activity of the target, the countries in which the target operates, the industry the target is in and the number of government customers and government touchpoints," she noted.

HPE, for example, does not have a written policy about anti-corruption risks relating to M&A, Rohr acknowledged, but it does have an established practice, she explained. In her first two years at HPE, Rohr was involved in nine acquisitions. M&A lawyers from the HPE legal department are on the deal team, Rohr said, and the company has "various due diligence work streams that are involved in every deal," she explained.

See "How to Mitigate FCPA Risk Before and After an Acquisition" (Feb. 18, 2015) and "Anti-Corruption Due Diligence Checklist for Mergers and Acquisitions" (Jun. 12, 2013).

Assembling a Strong Deal Team

Membership on deal teams can vary. Typically, it is on the acquiror to put together the M&A team, Olsen noted. Usually, "an M&A deal team includes relevant company operational personnel, in-house counsel and, maybe, an underwriter or professionals from a financial services company," Brown explained.

The team should also "include accountants who look at the financial stability of the organization being acquired," Olsen said. A "team of forensic accountants who will take a deeper dive and look specifically at bribery and corruption risk," is useful as well, Olsen continued.

In addition to deal lawyers, there should "be business team members from both sides that understand the industry, understand the asset and who will work with the deal team attorneys," Brown said.

Addressing Business-Versus-Compliance Tension

Compliance often seems to take a back burner to business interests during an acquisition. "An M&A deal team is usually determined by the business people," Brown explained. Any given deal, after all, "is a business transaction that the company has decided is strategically necessary or important," she said. "If the deal team is recognized and rewarded for closing deals and achieving the strategic vision, then it is not usually welcoming to processes that slow the transaction closing down," Brown observed. The reality is that "the deal team wants to close and the due diligence compliance team wants to review and uncover," and the two do not always work comfortably together, she acknowledged.

Any potential tension between those with a business focus and those with a compliance focus can be mitigated with effective leadership. "That is where the senior executives' 'tone at the top' matters, and where the CEO or the board makes it clear to the deal team that the deal cannot close, nor can any significant terms be achieved, without pre-merger due diligence being conducted and risks reasonably assessed so the board can decide if it is going to go forward" with the transaction, Brown said. "A lot of these transactions will require board approval," she noted. "So, if the deal team accepts that nothing can happen unless compliance due diligence is satisfactorily completed and any red flags neutralized, resolved or mitigated, then the deal team will be very accommodating to the M&A due diligence team."

Hiring Deal Counsel and Separate Anti-Corruption Due Diligence Counsel

At HPE, outside counsel, as well as in-house lawyers, work on the deal itself, and, interestingly, separate outside counsel are almost always hired "to assist with anti-corruption due diligence," Rohr said. "At HPE, someone from the anti-corruption team in the ethics and compliance office is always part of the M&A team," Rohr said. "We insist on being brought in early," she explained. "Part of that is to find any anti-corruption concerns that we might need to address in integration, but also to identify any serious anti-corruption concerns that could be a red flag about doing the deal," Rohr continued.

Of course, HPE appreciates the seriousness of FCPA compliance. "The HPE M&A deal team is good about getting anti-corruption lawyers into the room and facilitating anti-corruption diligence, perhaps because our predecessor company, HP Co., had an FCPA resolution with the DOJ and SEC in 2014, so people understand the importance," Rohr said. "It is still hard to get access to information especially because deals often move so quickly," she acknowledged.

See "Three Continents, Four Settlement Tools and $108 Million: HP Entities Resolve Criminal and Civil FCPA Charges" (Apr. 16, 2014).

Why Compliance Officers Might Not Be on the Team

Sometimes, compliance officers are on a deal team, but sometimes, they are not. HPE's approach is an interesting contrast to car rental company Avis Budget Group, which is also active in M&A. At a recent Society for Corporate Compliance and Ethics' European Compliance & Ethics Institute panel in Frankfurt, Germany, the director of business ethics and compliance at Avis mentioned that she is not a part of the M&A team, which can make compliance efforts a bit challenging.

Avis isn't alone in this model, PwC's Rivera explained. "It is not unusual that the core compliance team is not on the deal team," she said. "Team structure varies based on individuals' roles, the organization's structure, the significance of the deal and the need to keep matters confidential."

A company involved in a lot of deals might only involve the chief compliance officer in the big ones. "A conglomerate might have a number of industries under one corporate umbrella and, depending on what division the transaction is coming out of, there could be multiple proposed transactions in play in different parts of the company for different departments of different sizes," Brown said. "So, if there is one chief compliance officer, that person is not likely to be assigned as a part of every transaction team," she explained.

After all, the ABAC risks will vary from deal to deal. A company's chief compliance officer "may have a protocol for conducting due diligence that the business people can execute, and only if they find a 'red flag' would they involve the compliance officer or lawyer," Brown said. Of course, it is important that "anyone on the deal team that may encounter FCPA risk or red flags needs to know to identify issues and to escalate matters as they arise," Sloane said.

See "Practical Approaches to M&A Compliance From Avis Budget Group" (Jun. 27, 2018).