

# M&A: Navigating Anti-Corruption, Sanctions and Integration Risks

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<http://corruptioncrimcompliance.com>



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## Speaking from Experience: a Bit about Me

- **Gibson Dunn & Crutcher** (White Collar Defense; Siemens Monitorship)

- **Innospec Inc.** (in-house L&C)



- 3-year monitorship following global anticorruption resolution with SEC, DOJ, OFAC and SFO
- OFAC settlement: Innospec acquired a Swedish corporation with a local sales office in Cuba and did immediately stop transactions
- Acquired and integrated five companies (4 U.S. and 1 Europe) during my tenure

- **The Volkov Law Group** (White Collar Defense and Compliance)

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## Speaking from Experience: a Bit about Me

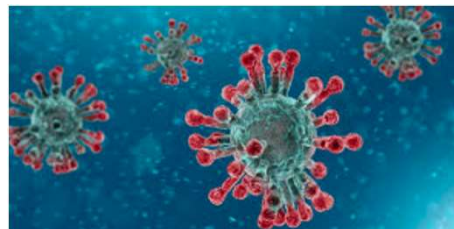


- Of Counsel at The Volkov Law Group
- Editor, *Handbook on Risk Management and the Law* for Routledge
- Member of ComplianceNet at UC Irvine School of Law
- Mediator and arbitrator
- Board member of National Contract Management Association, OC Chapter
- Received the Distinguished Instructor Award from UC Irvine

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First things first:  
COVID-19: Do we still care about this topic?



**Xerox abandons \$35 billion hostile bid for HP**

““While it is disappointing to take this step, we are prioritizing the health, safety and well-being of our employees, customers, partners and other stakeholders, and our broader response to the pandemic, over and above all other considerations,” Xerox said.

“The market rout triggered by the global coronavirus outbreak has led many companies to hit the pause button on mergers and acquisitions.”  
Forbes 4/3/20

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## M&A Activity Plunges, It Could Get Much Worse As Coronavirus Hits Markets And Prevents Face-To-Face Meetings



Sergei Klebnikov Forbes Staff

Markets

I cover breaking news, with a focus on money and markets.

- “the value of M&A activity in the first quarter [of 2020] was significantly lower than the last quarter of 2019, down 35% globally and 39% in the U.S.”

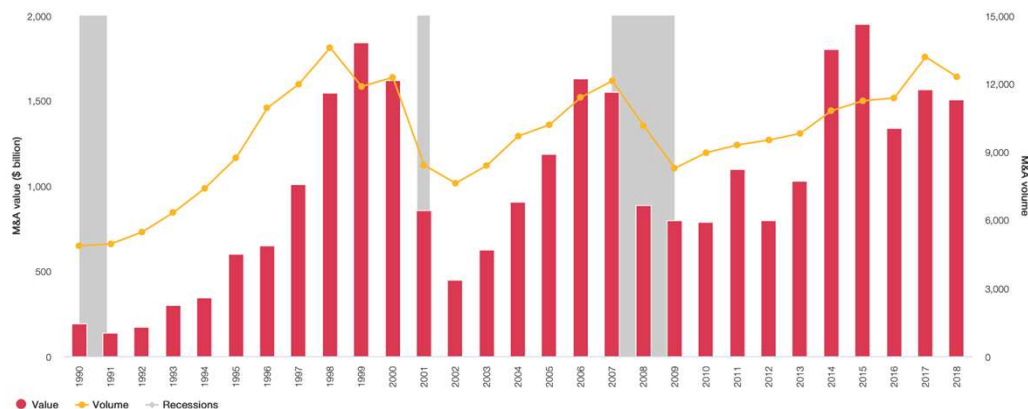
- “Just \$618 billion worth of deals have been completed in 2020 compared with \$956 billion by this time last year.”
- “In the U.S. the decline is even worse with a 50% year-over-year decrease in overall M&A value: Dealmaking for U.S. targets totaled just \$256 billion during the recently ended quarter—hitting a five-year low.”
- “Just four of the top 10 worldwide deals announced during the quarter took place in the U.S., bringing America’s overall share of global dealmaking to 35%, down from 52% a year ago—the lowest level since 2012.”

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## WE EXPECT A CONTINUED DECLINE, BUT WE WILL EVENTUALLY RECOVER

### Past M&A cycles and economic recessions

Total volume and value of deals by US acquirers declined substantially during recent downturns, taking years to recover.



Source: PwC analysis of Refinitiv data, National Bureau of Economic Research

© 2019 PwC

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### When Will the Vultures be Circling?

- Distressed companies can be attractive acquisition targets:
  - Their stock and debt often trade at reduced prices
  - They may be under pressure to sell assets or securities quickly to raise capital or pay down debt
  - They may be seeking non-bankruptcy solutions

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## Three Critical Concepts

- **Successor Liability (DOJ/OFAC)**
- **Due Diligence**
- **Post-Acquisition Integration**



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## Successor Liability in General

- As a general rule, when a company merges with or acquires another company, the successor company assumes the predecessor company's liabilities.
- Applied in various scenarios to ensure that companies do not reorganize or redesign themselves to escape liabilities.
- Generally attaches in **stock transfer or merger** because assets and liabilities of target company generally transfer to the acquiring company after closing.
- May attach in **asset purchase** depending on extent of purchase: inquiry focused on whether business of target is continuing or if agreement specifies which assets and liabilities transfer



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## Successor Liability and the FCPA

- Acquiring **Company A** can be held liable for FCPA violations committed by target **Company B** **BEFORE** and **AFTER** closing.
- Successor liability cannot create liability for conduct by **Company B** which was not prohibited **BEFORE** the closing. DOJ/SEC Resource Guide: "*The acquisition of a company does not create jurisdiction where none existed before*" (no jurisdiction over a foreign company's pre-acquisition misconduct where the foreign company was not subject to U.S. jurisdiction). **BUT:**



**Company A** may be subject to prosecution for any post-acquisition misconduct.

**Company A** may be liable if it fails to stop **Company B's** misconduct post-acquisition.

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## A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT

By the Criminal Division of the U.S. Department of Justice and  
the Enforcement Division of the U.S. Securities and Exchange Commission

### Example 5: Public Company Declaration

DOJ and SEC declined to take enforcement action against a U.S. publicly held consumer products company in connection with its acquisition of a foreign company. Factors taken into consideration included:

- The company identified the potential improper payments to local government officials as part of its pre-acquisition due diligence.
- The company promptly developed a comprehensive plan to investigate, correct, and remediate any FCPA issues after acquisition.
- The company promptly self-reported the issues prior to acquisition and provided the results of its investigation to the government on a real-time basis.
- The acquiring company's existing internal controls and compliance program were robust.
- After the acquisition closed, the company implemented a comprehensive remedial plan, ensured that all improper payments stopped, provided

extensive FCPA training to employees of the new subsidiary, and promptly incorporated the new subsidiary into the company's existing internal controls and compliance environment.



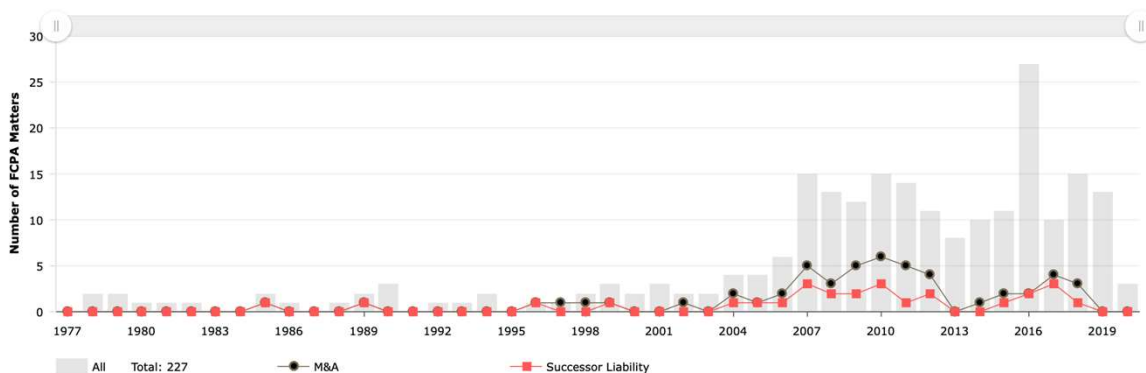
“Successor liability does not, however, create liability where none existed before. For example, if an issuer were to acquire a foreign company that was not previously subject to the FCPA’s jurisdiction, the mere acquisition of that foreign company would not retroactively create FCPA liability for the acquiring issuer.”

November 14, 2012

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## FCPA Successor Liability

Corporate Actions Initiated per Year Involving M&A and Successor Liability



From Stanford Law School's FCPA Clearinghouse, <http://fcpa.stanford.edu/statistics-analytics.html?tab=7>

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## 2017 FCPA Example

\$13 million



- On February 2, 2010, Mondelēz International acquired Cadbury Ltd.
- “Because of the nature of the acquisition, Mondelēz was unable to conduct complete pre-acquisition due diligence, including anti- corruption due diligence.”
- “Mondelēz engaged in substantial, risk- based, post-acquisition compliance-related due diligence reviews of Cadbury’s business,” but did not identify the misconduct.
- Cadbury’s subsidiary in India used a “consultant” to funnel bribes to government officials to obtain licenses and approvals for a chocolate factory in India.
- Cadbury India’s books and records, which were consolidated into the books and records of Cadbury and Mondelēz, did not accurately and fairly reflect the nature of the services rendered by the agent.

SEC Order: “As a result of Mondelēz’s acquisition of Cadbury stock, Mondelēz is also responsible for Cadbury’s violations.”

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- **eLandia acquired Latin Node in 2007 for \$20 million**
- Soon after, eLandia discovered that Latin Node used intermediaries to bribe government officials in Honduras and Yemen.

### **TOTAL WIPE OUT OF ITS INVESTMENT!**



- In 2009, eLandia self-disclosed to DOJ and pleaded guilty
  - eLandia paid \$2 million criminal fine
- In June 2008, LatinNode went bankrupt
- **\$ eLandia lost almost its entire investment, plus investigation costs**
- Former CEO of Latin Node was sentenced to 46 months in prison

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## OFAC Highlights the “Unique Sanctions Risks” Posed by Foreign Acquisitions

- OFAC has taken a hard stance with respect to sanctions compliance following foreign company acquisition. In 2019 alone:
  1. **Chubb Limited** as successor legal entity of the former ACE Limited, a Swiss company that provided provided for global travel insurance coverage without sanctions exclusionary clauses (insured Cuba-related travel)
  2. **Expedia** (foreign subsidiaries provided services for travel between other countries and Cuba);
  3. **Kollmorgen** (Turkish subsidiary provided goods and services in Iran);
  4. **Illinois Tool Works** (German subsidiary sold products in Cuba);
  5. **Stanley Black & Decker** (Chinese subsidiary sold to Iran via intermediaries)

See <https://blog.volkovlaw.com/2019/06/u-s-entities-engaged-in-m-ofac-highlights-the-unique-sanctions-risks-posed-by-foreign-acquisitions/>

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## What Sets Sanctions Compliance Apart? **Strict liability**

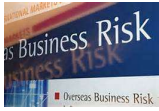
**Kollmorgen undertook “extensive preventative and remedial conduct” before and after the acquisition in an effort to ensure its subsidiary complied**

- Pre-acquisition, Kollmorgen hired an external law firm and an external auditing and consulting company to perform sanctions due diligence on target Elsim.
  - Discovered Elsim made sales to, and had customers in, Iran.
  - Determined it would need to take steps to prevent such sales from occurring post-acquisition.
- Post-acquisition implemented a “wide range” of compliance measures designed to ensure Elsim complied with U.S. sanctions
- In spite of Kollmorgen’s “extensive efforts” to ensure Elsim complied, for two years after acquisition, Elsim willfully engaged in prohibited transactions and covered it up.

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## The Antidote: Due Diligence

- Robust pre-acquisition due diligence is key – whether or not Company A discovers violations
- DOJ and SEC are more likely to excuse Company A from liability if Company A conducted a robust pre-acquisition due diligence
- DOJ and SEC may decline prosecution if Company A conducts robust pre-acquisition due diligence and fails to discover violations until post-acquisition
- Liability will turn on performance of due diligence and whether Company A had any involvement in post-acquisition bribery conduct

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## Due Diligence Purposes

- Identify potential corruption risks created by the proposed acquisition;
- Design appropriate anti-corruption contractual representations;
- Determine the scope and issues that need to be addressed in post-acquisition integration;
- Evaluate potential changes to personnel, contracts, markets and relationships;
- Communicate the company's commitment to ethics and compliance to the target company; and
- Document the due diligence review and process.

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## Covering All Your Bases

Conduct due diligence as if you are designing and implementing a new compliance and ethics program – what exists and what needs to be added?

- Create a Basic Risk Matrix: Nature of business, countries of operation, risky interactions with foreign officials, third parties
- Assess the Culture of Ethics and Compliance
- Review Structure: Role of the Board, the CEO, CCO and other senior managers
- Review Policies and Procedures: Code of Conduct, Third Party Due Diligence, Charitable contributions, Gifts, meals and entertainment and Hiring of relatives of foreign officials, Employee report, internal investigations and incentives/discipline
- Review Operations: Training and communications, Due diligence procedures, Audit and monitoring, Financial controls, Need and use of third parties

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## The Value of Due Diligence

- Provides important test of Company B's real financial performance (non-bribe dependent revenues)
- Reduces risk that acquired Company B will continue to pay bribes
- Provides valuable information needed to integrate Company B into Company A's compliance and ethics program, internal controls and overall operations
- Permits Company A and B to resolve any corruption issues prior to closing and eliminates risk of post-acquisition enforcement and litigation
- Demonstrates Company A's commitment to compliance and ethics, and preventing FCPA violations

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## What if Due Diligence is Legally Barred?

- Rare situation but Opinion Release 08-02 involving Halliburton set out procedures
- Strict procedures and timetables for conducting post-acquisition due diligence
- Protected Halliburton from successor liability
- DOJ recognizes that this is not much of a solution because it is stringent and requires extensive effort and continuous reporting to DOJ/SEC



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“A well-designed compliance program should include comprehensive due diligence of any acquisition targets.”

- “Pre-M&A due diligence enables the acquiring company to evaluate more accurately each target’s value and negotiate for the costs of any corruption or misconduct to be borne by the target.”
- “Flawed or incomplete due diligence can allow misconduct to continue at the target company, causing resulting harm to a business’s profitability and reputation and risking civil and criminal liability.”
- “The extent to which a company subjects its acquisition targets to appropriate scrutiny is indicative of whether its compliance program is, as implemented, able to effectively enforce its internal controls and remediate misconduct at all levels of the organization.”

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21 Mar 2013

## Kollmorgen Acquires Turkish Automation Specialists Elsim Electrotechnical Systems A.S.



### U.S. DEPARTMENT OF THE TREASURY

ENFORCEMENT INFORMATION FOR FEBRUARY 7, 2019

“This case highlights the importance of: (1) performing heightened due diligence, particularly with regard to affiliates, subsidiaries, or counterparties known to transact with OFAC-sanctioned countries or persons, or that otherwise pose high-risks due to their geographic location, customers and/or suppliers, or products and services they offer; and (2) implementing proactive controls when U.S. persons, directly or indirectly, acquire companies with preexisting relationships with sanctioned persons and jurisdictions.”

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## OFAC M&A Risks: How To Protect the Company

OFAC expects ***prompt adoption and implementation of compliance controls*** when U.S. companies acquire foreign companies that transact business in sanctioned jurisdictions.

- Conduct sanctions-related due diligence **before** and **after** acquisition
- Promptly train newly acquired subsidiaries
- Implement systematic controls to preclude unlawful transactions (block orders)
- Audit, monitor and verify newly acquired subsidiaries for OFAC compliance

***Even in cases where the newly-acquired company affirmatively misrepresents compliance and falsifies records to hide non-compliance, companies face significant penalties for violations.***

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

A Framework for OFAC Compliance Commitments

- “One of the multitude of areas organizations should include in their risk assessments—**which, in recent years, appears to have presented numerous challenges with respect to OFAC sanctions**—are mergers and acquisitions.”
- Compliance functions should be integrated into the merger, acquisition, and integration process.
- Engage in appropriate due diligence “to ensure that sanctions-related issues are identified, escalated to the relevant senior levels, addressed prior to the conclusion of any transaction, and incorporated into the organization’s risk assessment process.”
- Post-acquisition, the “Audit and Testing function will be critical to identifying any additional sanctions-related issues.”

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## M&A: Specific Considerations

This part of the presentation done by Virginia Suveiu

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## Specific Considerations

- False Claims Act & Government Contract Due Diligence
- Privacy & cybersecurity
- What's on the horizon...



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## False Claims Act

- Civil Liability (31 USC 3729)
  - Knowingly Presenting a False Claim [SEP]
  - Knowingly Making a False Statement [SEP]
  - Reverse False Claims
  - Conspiracy [SEP]
- Criminal Liability (18 USC 287)
- Anti-retaliation provisions (31 USC 3730)

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## United States ex rel. Medrano v. Diabetic Care RX, LLC

Late 2019, the DOJ reached a \$21.36 million settlement with Diabetic Care Rx LLC, d/b/a Patient Care America (PCA), two of PCA's executives and the PE firm Riordan, Lewis & Haden Inc. (RLH). The settlement indicates that the DOJ's allegations and legal theories against the defendants, including those against the defendant PE firm, may have been viable, and that the DOJ may continue naming PE investors in FCA actions going forward.

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## Government Contracts Due Diligence

Past/Current Compliance	Forward-looking
<ul style="list-style-type: none"><li>• Analysis of contract backlog</li><li>• Past performance history</li><li>• Claims, disputes, government investigations</li><li>• Internal investigations</li><li>• Audit liability (DCAA) and CAS</li><li>• SCA/DBA and related labor laws</li><li>• GSA/VA Schedule compliance</li><li>• Required business systems for government contractors</li><li>• Organization Conflicts of Interest (OCI)</li><li>• Socio-economic compliance (e.g., OFCCP, human trafficking) and other compliance programs</li><li>• Supply chain integrity</li><li>• Cybersecurity compliance</li></ul>	<ul style="list-style-type: none"><li>- Regulatory consents, security clearances, filing, registrations(e.g., novation, CFIUS, DSS, DDTC, FCC)<ul style="list-style-type: none"><li>• Significant amount of work if foreign assets and/or foreign company</li></ul></li><li>- Cost Accounting Standards<ul style="list-style-type: none"><li>• Indirect rate changes and cost impacts</li><li>• Allowability of organizational changes</li></ul></li><li>- Outstanding proposals<ul style="list-style-type: none"><li>• Protest risk associated with the transaction</li><li>• OCI risk</li><li>• Teaming agreements</li><li>• Joint ventures</li></ul></li><li>- IP rights and restrictions</li><li>- Key personnel</li></ul>

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## Privacy & Cybersecurity

- Increased Threats
- New Vulnerabilities
- “Heightened State of Cybersecurity”



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## Cybersecurity Specific to Government Contracts

- Defense Federal Acquisition Regulation Supplement (DFARS) 252.204-7012
- National Institute of Standards and Technology (NIST) Special Publication (SP) 800-171 Revision 3
- Cybersecurity Maturity Model Certification (CMMC)
- Questions to ask the target include:
  - Does the target conduct regular risk assessments to identify the threats and potential risks to CUI on its systems?
  - Does the target engage in regular monitoring and testing of its cybersecurity controls to ensure they are effectively deployed and perform properly?
  - Does the target regularly review and adjust its cybersecurity program in tune with changing federal cybersecurity requirements?
  - Does the target address the impact of any of third-party access to its systems (e.g., by third-party vendors, cloud providers, or outsourced providers)?

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## What's on the Horizon...

- Shareholder activism
  - 99% of the campaigns launched in 2019—47% of the overall total—were focused on M&A, a record number.
- COVID-19 & Material Adverse Effect
  - Three principal elements to define and analyze:
    1. Is the effect material and adverse? (Are forward-looking effects included?)
    2. Does the effect fall within any of the carve-outs?
    3. If so, is there an applicable disproportionate effect carve-out from the carve-outs?
  - The construct is an attempt to distinguish target-specific risks from broader business risks.

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## Voluntary Self-Disclosure and Integration

This part of the presentation done by Jessica Sanderson

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## FCPA Corporate Enforcement Policy 9-47.120

- Company earns presumption of declination:
  - Voluntary disclosure
  - Full Cooperation
  - Remediation
  - Absent aggravated circumstances (senior executive involvement, recidivist)
  - Still must pay disgorgement
- Applies in M&A context: “where a company undertakes a merger or acquisition, uncovers misconduct through thorough and timely due diligence or, in appropriate instances, through post-acquisition audits or compliance integration efforts, and voluntarily self-discloses the misconduct and otherwise takes action consistent with this Policy (including, among other requirements, the timely implementation of an effective compliance program at the merged or acquired entity), there will be a presumption of a declination in accordance with and subject to the other requirements of this Policy.”
- “In appropriate cases, an acquiring company that discloses misconduct may be eligible for a declination, even if aggravating circumstances existed as to the acquired entity.”

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## DOJ Guidance: Matt Miner Speech

- Matt Miner, DAAG Criminal Division gave speech on July 25, 2018 addressed application of 2017 FCPA Corporate Enforcement Policy:

“if an acquiring company unearths wrongdoing subsequent to the acquisition, we want to encourage its leadership to take the steps outlined in the FCPA Policy, and when they do, we want to reward them, accordingly for stepping up, being transparent, and reporting and remediating the problems they inherited.”
- Suggested using Opinion Procedure to gain clarity on difficult situations (promise to expedite reviews).

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## Opinion Release 14-02

- Requestor identified potential bribery payments and weaknesses in accounting controls. Target company was not subject to FCPA.
- DOJ affirms principle that target company's pre-acquisition conduct cannot create liability for acquiring company.
- Requester (acquiring company) proposed completing full integration of target company within 1 year, including training and application of anti-corruption policies and procedures and accounting controls.
- DOJ notes above and cites conducting a full FCPA audit and reporting any corrupt payments to DOJ
- DOJ concludes "does not presently intend to take any enforcement action with respect to pre-acquisition bribery Seller or the Target Company may have committed."

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Department of Justice

December 13, 2019  
[WWW.JUSTICE.GOV](http://WWW.JUSTICE.GOV)

NSD  
(202) 514-2007

EXPORT CONTROL AND SANCTIONS ENFORCEMENT POLICY  
FOR BUSINESS ORGANIZATIONS<sup>1</sup>

Policy of the Counterintelligence and  
Export Control Section (CES) of the  
DOJ's National Security Division (NSD)

when a company

- (1) **voluntarily self-discloses export control or sanctions violations to CES,**
- (2) **fully cooperates,** and
- (3) **timely and appropriately remediates,**

there is a presumption that the company will receive a non-prosecution agreement and will not pay a fine, absent aggravating factors.

**NOTE 7: presumption applies "When a company undertakes a merger or acquisition, uncovers misconduct by the merged or acquired entity through thorough and timely due diligence or, in appropriate instances, through post-acquisition audits or compliance integration efforts, and voluntarily self-discloses the misconduct and otherwise takes action consistent with this Policy (including, among other requirements, the timely implementation of an effective compliance program at the merged or acquired entity)"**

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## Post-Acquisition Integration

- DOJ recognizes that even the most robust acquisition due diligence is based upon limited information, and so allows for a grace period (although no time period is defined) to integrate the acquired company into the acquirer's ethics and compliance program and overall control environment.
- *"DOJ and SEC evaluate whether the acquiring company promptly incorporated the acquired company into all of its internal controls, including its compliance program."*



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## Focus on Post-Acquisition Compliance Audits, Compliance and Training

- DOJ and SEC have relaxed pre-acquisition due diligence consequences to focus on post-acquisition audit, compliance program implementation and training.
- New policies have been articulated in settlement agreements.
- Started with Johnson and Johnson 2010 settlement.
  - 18 months from closing to conduct FCPA audit of acquired operations
  - 12 months from closing to implement FCPA compliance program
- Data Systems and Solutions
  - FCPA audit, implement FCPA compliance program, FCPA training "as soon as practicable"

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## Integration Steps

- Ensure that acquiring company's Code of Conduct and Compliance policies apply as "quickly as practicable" to newly-acquired business;
- Train the directors, officers, and employees of newly acquired business, and when appropriate, train agents and business partners, on the FCPA, Code of Conduct and compliance policies and procedures;
- Conduct an FCPA-specific audit of newly-acquired business operations as quickly as practicable; and
- Remediate in response to any identified violations or high-risk practices

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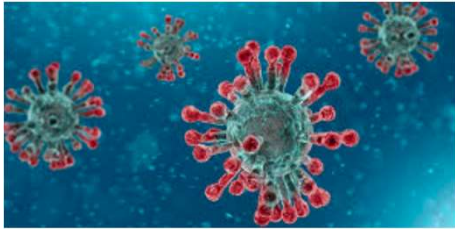


## FCPA Post-Acquisition Audit

Post-acquisition audit requires examination and assessment of:

- Countries of operation
- Industry risks
- Use of and payments to third-parties
- Full complement of government interactions (e.g. sales, regulatory) and touchpoints
- Gifts, meals, entertainment and travel
- Charitable donations, sponsorships
- Internal controls
- Age, quality, and comprehensiveness of anti-corruption compliance program
- Comprehensive accounting analysis with calculated sampling in high-risk countries to examine transactions and drill down into anomalies
- Must be conducted promptly (180 days post-closing )

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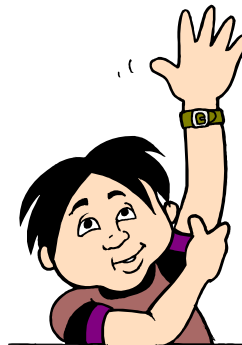
We begin and end with COVID-19

### **Major Issues with Pre- and Post-Acquisition DD and Integration**

- Limited access to documents: hard-copy, original documents are inaccessible
- Can you transfer data and documents across international borders without violating local privacy laws?
- Difficult if not impossible to inspect property: shuttered facilities
- Key employees working from home – no face-to-face interviews, no in-person training: How do you evaluate target's "culture"?
- How to implement policies and procedures and focus on compliance at target company when the workforce is dispersed and focused on health and safety?
- How do you meet the 180-day due diligence review and self-reporting period?

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## **Questions**



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