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Client Alert Commentary

White Collar Defense & Investigations Practice

January 12, 2015 | Number 1787

DOJ Guidance Underscores Importance of Anti-corruption Due Diligence in International M&A Transactions

FCPA Opinion Release provides insight into the jurisdictional reach of the FCPA and the level of due diligence the DOJ expects.

On November 7, 2014, the US Department of Justice (DOJ) issued its second and final Foreign Corrupt Practices Act (FCPA) Opinion Release of the year, providing insight into the level of due diligence DOJ expects as part of international mergers and acquisitions. The Opinion Release also confirmed that pre-acquisition conduct by a foreign target company without a jurisdictional nexus to the United States would not be subject to FCPA enforcement. The Opinion Release is a reminder to US companies and issuers that effective due diligence and integration plans are critical to ensuring they do not become liable for improper conduct by their newly acquired companies after the acquisition is complete.

Overview of the Opinion Release

DOJ issued FCPA Opinion Release 14-02 in response to an inquiry by a multinational consumer products company headquartered in the United States (the Requestor). During pre-acquisition due diligence into a foreign consumer products company and its subsidiary (collectively, the Target), the Requestor uncovered a number of likely improper payments to foreign officials, as well as substantial accounting and recordkeeping weaknesses. According to the Requestor, these potentially improper payments had no discernible jurisdictional nexus to the United States. As part of the pre-acquisition process, the Requestor set forth a remedial pre-acquisition and post-acquisition plan to address anti-corruption concerns. Based on these facts and circumstances, the Requester sought an opinion from DOJ that the government would not bring an FCPA enforcement action against the Requestor for the Target's pre-acquisition conduct which, at the time of the conduct, did not have any jurisdictional nexus to the United States.

As part of its due diligence, the Requestor retained an experienced accounting firm to review approximately 1,300 of the Target's transactions, which uncovered more than US$100,000 in transactions that raised compliance issues. The accounting firm also identified cash payments and gifts to government officials to obtain permits and licenses; gifts and cash donations to government officials; potentially improper charitable contributions and sponsorships; and payments to members of the state-controlled media to minimize negative publicity. Due diligence also uncovered significant recordkeeping deficiencies, improper or incorrect classification of expenses, and disorganized and missing records. Finally, the Requestor learned that the Target had not developed or implemented a written code of conduct or other compliance policies and procedures.

According to the Opinion Release, the Requestor took pre-closing steps to remediate the Target's "glaring compliance, accounting, and recordkeeping deficiencies," and anticipated fully integrating the Target into

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its compliance and reporting structure within one year of closing. The Requestor established an integration schedule that encompassed implementing risk mitigation; disseminating and training on compliance procedures and policies; standardizing relationships with business partners; and formalizing accounting and recordkeeping at the Target.

Based on these facts and circumstances, DOJ stated in the Opinion Release that it would not take any enforcement action against the Requestor with respect to the Target's pre-acquisition conduct. Citing the FCPA Resource Guide, DOJ explained that "successor liability does not … 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." *See* *FCPA – A Resource Guide to the U.S. Foreign Corrupt Practices Act*, at 28. *See also* "Scenario 1," *id.* at 31.

Factors Relevant to Jurisdictional Analysis

DOJ referenced a number of factors in the Opinion Release that evidenced a lack of jurisdictional nexus to the pre-acquisition conduct by the Target, including:

- Target and its seller (a foreign corporation with stock listed on a foreign exchange) have never been issuers of securities in the United States.
- Target and its seller have had negligible business contacts in the United States.
- Target and its seller have had no direct sale or distribution of their products in the United States.
- None of the potentially improper payments, donations, gifts, contributions or sponsorships occurred in the United States.
- None of the potentially improper payments were made by or through a US person or issuer.
- No contracts or other assets that were acquired through bribery would remain in operation following the acquisition from which the Requestor would derive financial benefit. Although the DOJ did not elaborate on this point, the Opinion Release seems to suggest that if the improperly obtained contracts or assets were to remain in operation after the acquisition, this could expose the Requestor to liability for the Target's prior improper conduct.

DOJ Recommendations Regarding Anti-corruption Due Diligence

DOJ encouraged companies engaging in M&A transactions to take five steps to ensure FCPA compliance in the context of merger and acquisition activity:

1. Conduct thorough risk-based FCPA and anti-corruption due diligence
2. Implement the acquiring company's code of conduct and anti-corruption policies as quickly as practicable
3. Conduct FCPA and other relevant training for the acquired entity's directors and employees, as well as third-party agents and partners
4. Conduct an FCPA-specific audit of the acquired entity as quickly as practicable
5. Disclose to DOJ any corrupt payments discovered during the due diligence process

Reactions to DOJ Recommendations

Of course, as all FCPA Opinion Releases make clear, this Opinion Release is limited to the Requestor's specific facts, circumstances and representations. While some of the recommendations may not be practical in all transactions, especially in a competitive bidding situation, the Opinion Release gives all companies engaged in international mergers or acquisitions a framework for the level of due diligence the DOJ expects. We describe below a number of factors that were evident in this case, or that may be present in future cases, that may impact how companies interpret the Government's recommendations:

1. **Conduct thorough risk-based FCPA and anti-corruption due diligence**. In this case, after identifying indicia of improper payments in the early stages of due diligence, combined with heightened risks associated with the Target, the Requestor engaged an experienced accounting firm to conduct an extensive review of the Target's books and records. In any transaction, adequate, risk-based due diligence will depend on the risks associated with the target company, including but not limited to the following categories of risk: geographies and industries where the target operates; nature, scope and frequency of government interactions, including in the sales and regulatory contexts; nature and scope of third party relationships; business practices of the company, including gifts, travel, entertainment, charitable donations, or political donations; and whether the target company has a history or reputation of corrupt or unethical conduct.

2. **Implement the acquiring company's code of conduct and anti-corruption policies as quickly as practicable**. Here, the Requestor took post-acquisition/pre-closing steps to begin remediating the improper conduct, and established a timeline for integrating the Target into its existing compliance program. Often, acquisition targets are embedded in a parent company's corporate compliance program, and once extracted from the larger corporate organization, will be left without an adequate compliance program. Acquiring companies should be sure to implement their own compliance program — or a standalone program at the target — as soon as practicable after the transaction.

3. **Conduct FCPA and other relevant training for the acquired entity's directors and employees, as well as third-party agents and partners**. In this case, the Requestor included dissemination and training on compliance procedures and policies as part of its integration plan. In most transactions, this training should be provided to personnel who work in high-risk functions (*i.e.*, sales, regulatory, accounting, management), in high-risk jurisdictions, and in business units or regions where improper or questionable conduct was identified during pre-acquisition due diligence.

4. **Conduct an FCPA-specific audit of the acquired entity as quickly as practicable**. In other words, due diligence cannot end with pre-acquisition due diligence. In this case, the DOJ encouraged a targeted FCPA audit post-acquisition or post-closing, which would take place after the acquiring entity has additional access to the target. This reiterates DOJ guidance from FCPA Opinion Release 08-02, which detailed a 180-day post-closing plan addressing, among other things: the use of agents and other third parties; commercial dealings with state-owned customers; any joint venture, teaming or consortium arrangements; customs and immigration matters; tax matters; and any government licenses and permits.

5. **Disclose to the Department any corrupt payments discovered during the due diligence process**. In this case, the Requestor disclosed to DOJ corrupt payments that fell outside of the jurisdiction of the FCPA. Companies and their counsel will need make a fact-intensive, case-specific assessment of whether or not to disclose improper conduct identified during due

diligence to DOJ. The FCPA Resource Guide encourages disclosure, noting that in "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. And 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." *See* *FCPA – A Resource Guide to the U.S. Foreign Corrupt Practices Act*, at 28.

Conclusions

Although the Opinion Release confirms that pre-acquisition conduct without a US jurisdictional nexus is not subject to FCPA jurisdiction even after acquisition by a US company, the Opinion Release also underscores the importance of conducting pre-acquisition due diligence on international targets and establishing an effective compliance integration plan. If improper conduct continues post-acquisition, it could be subject to FCPA jurisdiction. Therefore, companies should have plans in place for "Day 1" to ensure problematic conduct is identified, addressed and remediated appropriately. In addition, because the recommendations include incorporating a target into an acquirer's own anti-corruption compliance program, acquirers should take care to maintain robust and active anti-corruption compliance programs, not only to protect their own operations, but also their newly acquired businesses.

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