Bloomberg BNA

Corporate Law & Accountability Report™

MERGERS AND ACQUISITIONS

Legal Due Diligence in International M&A



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In today's global environment, legal due diligence is not simply a procedural hurdle. It is a key component of any international M&A deal. Enforcement efforts by regulators worldwide and the political demands for corporate accountability are at an all-time high and must be considered in corporate acquisitions or restructurings. M&A deals can create, or transfer to the successor company, not only liability for violations by the target company, but also the concomitant costs—both reputational and pecuniary—of any subsequent investigation and enforcement action. This means that a target company's true value cannot be determined without considering all the relevant legal issues, and it makes legal due diligence an essential step in any cross-border M&A deal.

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U.S. anti-bribery and antitrust laws present particularly important issues given their international reach, the specter of successor liability and U.S. regulators' active role in cross-border enforcement. Non-U.S. companies, whether incorporated in Asia, Europe or elsewhere, must be aware of the issues these laws present and tailor their legal due diligence protocols appropriately to assess the risks.

Bribery & Corruption

Enforcement Framework and Risk

The U.S. Foreign Corrupt Practices Act ("FCPA") broadly prohibits corrupt payments to foreign governmental officials to obtain or retain business.[1] It applies to any entity listed on a U.S. stock exchange, any U.S. person or business, and certain persons or entities acting within the U.S.[2] Thus, the substance of the FCPA's prohibitions and the breadth of its jurisdiction inherently extend to extraterritorial conduct, making it an important issue for any company that operates interna-

[1] *See* 15 U.S.C. §§ 78dd-1, 78dd-2; Criminal Division of the U.S. Department of Justice and Enforcement Division of the U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* 2 (2012) (hereinafter "*FCPA Guidance*"), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

[2] *See* 15 U.S.C. §§ 78dd-1, 78dd-2; *FCPA Guidance* at 2.

tionally and has a nexus to the U.S. Moreover, the FCPA is enforced by the U.S. Department of Justice (''DOJ'') and Securities and Exchange Commission (''SEC''), which have been empowered in the wake of the financial crisis with enforcement mandates and significant authority to pursue matters extraterritorially, reinforcing the importance of these issues for companies operating with a nexus to the U.S.

Additionally, the DOJ and SEC have made clear that they can and will pursue successor entities, or parents of newly acquired subsidiaries or affiliates for FCPA violations, making the FCPA an important consideration for companies engaged in M&A activity.[3] For example, the DOJ and SEC issued FCPA joint guidance in 2012 directly addressing successor liability and explaining that ''[s]uccessor liability applies to all kinds of civil and criminal liabilities, and FCPA violations are no exception.''[4] And the DOJ recently restated its view on successor liability in an Opinion regarding a company's plan to acquire a foreign consumer products company and its wholly owned foreign subsidiary, providing that ''where a purchaser acquires the stock of a seller and integrates the target into its operations, successor liability may be conferred upon the purchaser for the acquired entity's pre-existing criminal and civil liabilities, including, for example, for FCPA violations of the target.''[5] These pronouncements follow a 2010 guilty plea for FCPA violations from Alliance One International AG, a Swiss corporation formed in 2005 when Dimon Inc. and Standard Commercial Corp. merged.[6] Alliance One's plea related to conduct committed by employees and agents of Dimon and Standard that predated the 2005 merger.[7] In other words, the DOJ charged the post-merger entity for the pre-merger conduct of the merged entities' foreign subsidiaries.[8] Thus, U.S. authorities' enforcement history and recently issued guidance clearly outline the FCPA risk created by successor liability in the international M&A context.

Anti-Bribery Due Diligence

In addition to outlining the agencies' position on successor liability, the 2012 DOJ-SEC joint guidance also made clear that companies can take steps to mitigate the risks associated with successor liability. Chief among these steps is meaningful legal due diligence, which according to the agencies' joint guidance: ''helps an acquiring company . . . accurately value the target company,'' reduces ''the risk that the acquired company will continue to pay bribes,'' allows the parties to handle the consequences of potential violations ''in an orderly and efficient manner,'' and ''demonstrates a genuine commitment to uncovering and preventing FCPA violations.''[9]

Legal due diligence related to the FCPA can begin with some basic inquiries by the acquiring company that do not require information from the target. Such inquiries include:

- whether the target company operates in a country with a history or culture of bribery and corruption;[10]
- whether the target company operates in an industry where bribery or corruption are more likely–for example, an industry in which participants bid for government contracts; and
- whether there are any publicly reported cases of bribery by the target company or any of its competitors.

The DOJ-SEC guidance also offers helpful examples of the types of inquiries in which entities should engage. Specifically, the joint guidance indicates that an acquiring entity is unlikely to be prosecuted for FCPA violations if, prior to acquisition, it has conducted the following due diligence:

- a review of the target entity's sales and financial data, customer contracts, and third-party and distributor agreements;
- a risk-based analysis of the target's customer base to identify, for example, whether its customers include governmental entities;
- audits of a sample number of transactions for bribery and corruption risks; and
- a discussion with the target company's legal, sales and audit teams regarding the target company's corruption risks, existing compliance framework and any other relevant issues.[11]

These steps can protect a company from unanticipated FCPA liability related to international M&A activity.

If a target company is reluctant to provide this information, the acquiring company may infer that there could be an issue related to corrupt practices at the target company. Where an acquiring company has limited access to information and may be hampered in its ability to conduct legal due diligence thoroughly, the company may look to the DOJ's FCPA Opinion Procedure, in which a company can describe a plan for prospective conduct and the government will opine on whether it would prosecute any action in light of the prospective conduct.[12] For example, in Opinion Release 08-02, Halliburton, faced with ''insufficient time and inadequate access to information to complete appropriate FCPA and anti-corruption due diligence'' of a target company, set forth its plan for (a) limited pre-closing due diligence, (b) more detailed post-closing review, and (c)

[3] See generally *FCPA Guidance*.

[4] *Id.* at 28 (citations omitted).

[5] U.S. Department of Justice, Opinion Release No. 14-02 (Nov. 7, 2014), *available at* http://www.justice.gov/criminal/fraud/fcpa/opinion/2014/14-02.pdf. As described further below, the DOJ's FCPA Opinion Procedure allows companies and individuals to seek the DOJ's opinion on certain described prospective conduct and, specifically, whether the DOJ would or would not intend to prosecute the conduct, as described. See *FCPA Guidance* at 29; 15 U.S.C. §§ 78dd-1(e), 78dd-2(f).

[6] Press Release, U.S. Department of Justice, *Alliance One International Inc. and Universal Corporation Resolve Related FCPA Matters Involving Bribes Paid to Foreign Government Officials* (Aug. 6, 2010). Alliance One also settled a civil action with the SEC. *Id.*

[7] *Id.*

[8] *Id.*

[9] *FCPA Guidance* at 28.

[10] This can involve simple Internet searches or publicly available resources, like the Corruption Perception Index published by Transparency International, which is available at: http://www.transparency.org/research/cpi/overview.

[11] *FCPA Guidance* at 32.

[12] *See FCPA Guidance* at 29; 15 U.S.C. §§ 78dd-1(e), 78dd-2(f).

   ISSN 2330-6300

prompt post-closing reporting of suspected violations and cooperation with the DOJ.[13] The DOJ opinion stated that based on Halliburton's representations, it did ''not presently intend to take any enforcement action against Halliburton for'' certain specified conduct.[14]

The Opinion Procedure, however, presents conflicting considerations. Although a party can obtain added certainty that it is not acquiring FCPA liability, the process takes time, and the DOJ's opinion, in exchange for assurances from the DOJ, ''will likely contain more stringent requirements'' for the acquiring entity to avoid prosecution ''than may be necessary in all circumstances.''[15]

If an acquiring entity accesses information and conducts thorough due diligence without identifying a violation or major risks, then it can move forward with greater comfort and a better sense of the target company's ''value.'' Similarly, if it encounters a violation or major risks, then it can assess the impact on the ''value'' of the target company, including future liabilities for potential violations. The acquiring entity also will need to consider how best to proceed in the event that it identifies a violation or potential violation, including the possibility of an internal investigation and reporting any violations to regulators as the deal progresses.[16] While such an analysis is beyond the scope of this article, the key point is that taken together, the substance of the FCPA's prohibitions (foreign bribes), the breadth of its jurisdiction (foreign or domestic actors), and its potential application to successor or parent entities make FCPA issues a critical component of any legal due diligence framework. Accordingly, a company engaged in international M&A activity with a target company subject to the FCPA should not move forward without conducting the diligence described above.

Antitrust

Enforcement Framework and Risk

Companies involved in international M&A also must incorporate antitrust considerations into their legal due diligence analysis, particularly given the uptick in major cross-border antitrust enforcement actions. U.S. antitrust laws present the same risks as the FCPA in connection with international M&A deals: they have extraterritorial reach and they recognize successor liability.

First, U.S. antitrust laws do not apply only to U.S. actors. Instead, their scope is defined by the proscribed conduct's effect on U.S. commerce or ''in the United States,'' an increasingly low threshold in the global economy, and one that may be less apparent in an M&A deal than the defined territorial boundaries of a target's operations or its primary place of business.[17] The DOJ's ongoing auto parts investigation, the largest cartel investigation in its history, illustrates this point well because it has ensnared primarily Japanese manufacturers that manufactured auto parts sold to U.S. automakers or incorporated into cars bought by U.S. consumers, and thus found themselves subject to U.S. antitrust laws.

Second, as in the FCPA context, antitrust enforcement presents issues of successor liability. For example, in December 2011, the DOJ executed a Non-Prosecution Agreement with Wells Fargo Bank as the successor to Wachovia Bank in connection with an investigation of bid rigging, and other conduct by Wachovia and its employees prior to its merger with Wells Fargo.[18] Given the breadth of U.S. antitrust laws, in the context of international M&A deals, companies also must look for and assess the risk of antitrust violations at the target company.

Antitrust Due Diligence

Legal due diligence focused on antitrust risks can start in the same way as anti-bribery due diligence–with a basic analysis that includes whether the target operates in countries with a history or culture of collusion or anti-competitive behavior, whether the target operates in a concentrated industry with few actors and significant barriers to market entry (increasing the likelihood of potentially anti-competitive practices), and whether there are any publicly reported cases of collusion or other anti-competitive practices by the target entity or any of its direct competitors. The due diligence then should assess antitrust issues more deeply and include the following inquiries:

- review the target company's antitrust compliance program (if one exists), including the compliance manuals and policies, the ways in which the program is administered and who administers it, and whether the compliance program includes a process for whistle-blowers to report violations;
- request that the target company compiles a list of competitors, suppliers and customers, and review the list for potential antitrust risks;
- request that the target company provide a list of trade associations or other advocacy groups to which it belongs and joint ventures or similar arrangements to which it is a party with competitors, suppliers or customers;
- assess any connections between directors, executives or owners of the target company and any interests in the target company's competitors, suppliers or customers; and
- review whether the target company has any pending investigations related to antitrust issues, including discussions with the target company's legal and compliance personnel.

The due diligence described above is critical to valuing a target company accurately and assessing the risks

[13] U.S. Department of Justice, Opinion Release No. 08-02 (June 13, 2008), *available at* http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0802.pdf.

[14] *Id.*

[15] *FCPA Guidance* at 29.

[16] See *id.* at 29–33 (emphasizing importance of self-reporting).

[17] *See* Hartford Fire Ins. Co. v. California, 509 U.S. 764, 795–96 (1993); 15 U.S.C. § 6a.

[18] Letter from Sharis A. Pozen, Acting Assistant Attorney General, Antitrust Division, to Karen Patton Seymour, Partner, Sullivan & Cromwell LLP (Dec. 8, 2011), *available at* http://www.justice.gov/atr/public/press_releases/2011/278076a.pdf; *see also* United States v. Wilshire Oil Co. of Texas, 427 F.2d 969, 974 (10th Cir. 1970) (rejecting defendant's argument that it could not be held liable for antitrust violations because it ''unwittingly bought into [the] ongoing conspiracy'' by acquiring another company and finding that the company ''had ample opportunity'' to discover and stop the illegal practices).

associated with any acquisition, but antitrust considerations also illustrate that any due diligence requires a balanced approach. The acquiring entity and target entity must be careful not to go too far. Specifically, to the extent entities share too much information or effectively ''merge'' certain aspects of their businesses before closing the deal, both companies can potentially run afoul of two U.S. antitrust laws: the Hart-Scott-Rodino Act (''HSR Act'') and the Sherman Act.

The HSR Act prohibits parties involved in a deal from transferring ''beneficial ownership'' or ''control'' prior to the expiration of statutorily imposed waiting periods that allow the U.S. government to assess the anticompetitive effects, if any, of the merger or acquisition.[19] Typical violations include one party ceding certain decisionmaking authority to the other party before the waiting period ends.

The second possible issue arises if the two merging entities are competitors, in which case their coordinated pre-merger conduct may constitute a violation of the Sherman Act, which prohibits agreements in restraint of trade, like price fixing, bid rigging and market allocation.[20]

[19] *See* 15 U.S.C. § 18a.
[20] *See* 15 U.S.C. § 1.

These regimes, which relate most directly to sales or other commercial activities during the pendency of a deal, involve highly fact-dependent issues and will not be fully addressed here. As they relate to pre-merger legal due diligence, the key takeaway is: never share commercially sensitive information with a transaction counterparty without first consulting counsel, and, if any such information is to be shared–for example, for valuation purposes–create a ''wall'' between the due diligence team and the commercial operations, either through hiring external advisors or by limiting communications within the organization.

Conclusion

Legal due diligence is a critical component of any international M&A deal. U.S. anti-bribery and antitrust laws present particularly important considerations because of their extraterritorial application and the post-closing specter of successor liability for companies engaged in M&A deals. A meaningful due diligence protocol should include inquiries designed to assess the risks posed by target entities under these legal regimes.

   ISSN 2330-6300