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Insights on Fraud Mitigation

Mitigating anti–corruption risks in M&A deals

(United States Department of Justice Opinion Release 14-02)

December 2014

Foreword

We are pleased to present the second edition of **Insights on Fraud Mitigation** - a periodic newsletter that will provide you with a focused analysis, tips and tricks on dealing with the ever growing risk of fraud, bribery and corruption.

In this issue, we analyse and comment on the recent United States Department of Justice (Opinion Release 14-02) that outlines the regulator's view when companies discover potential FCPA (Foreign Corrupt Practices Act) violations at a Target during pre-acquisition M&A diligence. This Opinion has significant learnings for companies in India that are exploring joint venture or other M&A transactions with a US entity.

We hope that you find this edition useful and of relevance to you.

We look forward to hearing from you. Should you have any questions, concerns or suggestions for future topics, please feel free to write to us.

Vidya Rajarao
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Corporate deal making is slowly revving up and we are witnessing an increase in merger and consolidation activity. At Grant Thornton, we believe that it is an opportune time to bring to your notice a recent opinion from the Department of Justice (DoJ) in the United States (Opinion Release 14-02[1]), which has significant learnings for any deal, which has at least one party that has a US touch point.

What is the Opinion Release 14-02 about?

Released on 07 November 2014, the opinion is about a US based MNC (the "Requestor"), which wishes to acquire a foreign products company and its wholly owned subsidiary (Target Company). The parent was a listed entity in a non-US jurisdiction. As per the Opinion Release, the target entities were not US issuers and had negligible US contacts, including sales and distribution. In the course of its pre-acquisition due diligence, the Requestor identified a number of "apparent improper payments, as well as substantial accounting weaknesses and poor record-keeping" at the Target Company.

This case had a number of similarities to issues that are typically identified in any pre-acquisition diligence, including, payments to government officials related to obtaining permits and licenses, gifts and cash donations to government officials, charitable contributions and sponsorships, payments to members of the state-controlled media to minimise negative publicity. In addition, there were instances of inaccurate classification of expenses, absence of underlying records for the tested transactions. Also, the Target Company had not developed or implemented a written code of conduct or other compliance policies and procedures.

As a result, after these issues were identified during the diligence process, the Requestor drew up an integration schedule to cover these aspects.

Based on the facts represented by the Requestor, the DoJ opined that it will not bring any enforcement action with respect to the conduct identified by the Requestor.

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Source: [1]http://www.justice.gov/criminal/fraud/fcpa/opinion/2014/14-02.pdf.

Why does this Opinion Release matter?

This Opinion Release should be read in the context of the 2012 Resource Guide to the US FCPA and various other cases decided by the DoJ from time to time on pre-acquisition diligence (such as Halliburton Opinion Release[2]), where successor liability for the actions of acquired company on the acquirer is enunciated for the purposes of the FCPA.

Quoting the Resource Guide, the DoJ has emphasised that successor liability does not create a liability when *none existed before* and cited an example in the Resource Guide - if an issuer were to acquire a foreign company that was not previously subject to the FCPA's jurisdiction, then mere acquisition of that foreign company would not retroactively create FCPA liability for the acquiring issuer.

This Opinion Release is important for several reasons. First, this is a much more flexible approach of the DoJ. The previous approach outlined in the Halliburton Opinion Release had aggressive and strict implementation timelines, while in the current Opinion Release, the DoJ seems to have adopted a more flexible approach. Needless to add, acquirers are best advised to bring the compliance culture of the target entities in sync as soon as practicable.

Second, the DoJ relies on representations from the Requestor that "…based on its due diligence, no contracts or other assets were determined to have been acquired through bribery that would remain in operation and from which Requestor would derive financial benefit following the acquisition". This, in some ways, expands the scope of successor liability that the DoJ has enunciated in its Resource Guide and other pronouncements. This would mean that acquirers would now be required to move beyond the past conduct and also look for those contracts that were obtained through improper means and would "financially benefit" the successor entity. This would mean that the resulting legal structure (for example, by placing identified contracts in a separate Special Purpose Vehicle) would have to undergo a change to factor this aspect.

Source: [2]http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0802.pdf.

What should you be doing in the next acquisition:

Following are some of the key aspects that you should consider in your next diligence. Needless to add, there is no one size fits all. In fact, the DoJ also admits this when it mentions that "The circumstances of each corporate merger or acquisition are unique and require specifically tailored due diligence and integration processes."

A. conduct a detailed risk-based FCPA diligence prior to any acquisition. This diligence should focus on identifying issues with respect to both aspects of the FCPA – anti-bribery and books and records.

B. implement acquirer's code of conduct and anti-corruption policies as quickly as practicable.

C. conduct training on FCPA and other relevant training for the acquired entity's directors and employees, as well as third-party agents and partners.

D. if there is any tainted conduct that is identified, devise an integration plan that ensures risk mitigation, training of internal and external stakeholders with regard to compliance procedures and policies, take all the necessary steps with respect to third parties (i.e. risk based background checks, periodic audits, etc.), and devise the accounting and record-keeping in line with the requirements under the FCPA.

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