Anti-Corruption Diligence in the M&A Context

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A successful merger or acquisition requires careful consideration of many components and diligence in a number of specialties. Corruption issues, generally, and the global reach of the Foreign Corrupt Practices Act and the U.K. Bribery Act 2010, specifically, can present unique challenges to the structure of a deal and a party's approach to diligence. The requirements of anti-corruption deal diligence should be considered at the presigning stage, in connection with the deal structure and after closing. Additionally, less-common approaches to limiting corruption risk can be employed when issues arise.

Before Signing

No predetermined blueprint for anti-corruption deal diligence exists. Current diligence request lists and past approaches are useful but must be adjusted to encompass potential issues for the specific transaction. An acquirer should tailor diligence to the potential target company or investment opportunity, its contact with government officials abroad (including employees of state-owned or controlled enterprises), and the contemplated deal structure. In doing so, it should consider the size of the proposed transaction and whether time and information constraints prior to signing a deal may restrict the scope of diligence. A best practice for acquirers and their advisers is to prioritize regions and topics, including:

- anti-corruption certifications;
- geographic risk;
- sector risk (*e.g.*, targets operating in the oil and gas or pharmaceutical industries);
- regulatory risks (*e.g.*, jurisdictional nexus of the investment);
- business model and operating risks;
- financial and ledger analysis; and
- recruitment risks (*e.g.*, concern that target has hired high-risk individuals or their relations).

In considering the scope of diligence, the amount of information made available for review will depend somewhat on whether the target company is a private or public company. More information may be provided to the acquirer in a private deal, whereas a deal involving a public target may require the counterparty to exhaust publicly available information as well as implement more rigorous post-closing diligence in the integration process.

During the Structuring of a Deal

A deal's structure and the terms of the acquisition agreement may be crafted or modified to offer the acquirer increased protection from corruption-related liability. While not a substitute for adequate due diligence in mitigating corruption risks, representations and warranties in the contract may be used in conjunction with disclosure schedule requirements as a means to gather information prior to signing. Parties also can use closing conditions and indemnification provisions to allocate corruption risk at and after closing. In more extreme cases or where risks are isolated in jurisdictions or businesses that are less significant to the overall transaction, it may be feasible (and preferable) to structure the deal to exclude high-risk regions or business units entirely.

Insurance

Insurance products may help as well. Representation and warranty insurance offers a useful layer of protection but has certain limitations. Anti-corruption-related coverage for the breach of a target company's representation regarding compliance may need to be negotiated specifically with the insurer, which will conduct its own deal diligence prior to underwriting a policy. Even if such coverage is included, a typical buyer-side limit of coverage of 10 percent of the purchase price may not fully address the costs associated with a compliance problem. Further, insurance does not cover the diminution of value of the acquired company that may result from the discovery of large-scale corruption issues.

Investigation insurance may protect against costs of investigations by the Securities and Exchange Commission, Department of Justice or other relevant enforcement authorities but typically will not cover liability fines and penalties. Finally, consider that policy limits may be inadequate given fees associated with large-scale, multijurisdictional anti-corruption investigations.

Phased Investment

One novel approach to managing anti-corruption risk is a phased or staged investment in a target company. An acquirer that is not comfortable with a target's corruption risk may consider an initial, limited investment, which should be well below the threshold at which regulators will impute control. The acquirer can invest further if the target company meets compliance benchmarks. For instance, the acquirer can increase its investment in years two through five if the target meets detailed anti-corruption compliance metrics. Additionally, the acquirer may consider negotiating an exit option for breach of compliance covenants. Where specific individuals within the target entity may have a unique heightened corruption risk, side-letters may be negotiated to memorialize personal compliance commitments. Arrangements of this nature are uncommon, but the investor may be able to balance the burden and demonstrate genuine interest in the ultimate investment by assuming the cost for some of the compliance enhancements.

Post-Closing

After closing a deal, an acquirer should assume that any prior corrupt practices and related violations of the target company will become the acquirer's responsibility. Regulators rarely take enforcement action for preclosing activities unless they have continued post-closing; however, it is in the acquirer's interest to promptly remediate any known issues and to implement its anti-corruption compliance regimen at the acquired entity as soon as possible. Appropriate post-closing diligence and integration will be beneficial to limiting potential liability for preclosing wrongful conduct. Major corruption issues should be identified, considered with appropriate counsel, remediated and reported to enforcement authorities as appropriate.

Integral in this diligence and integration process is a holistic approach that establishes and regularly reinforces the tone at the top and includes visits to the field for diligence reviews and substantive training seminars. An effective compliance program starts at the corporate office and should be communicated regularly in a meaningful manner to an entire organization, wherever in the world it operates.