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M&A in emerging markets
A fresh look at successor liability associated with the Foreign Corrupt Practices Act (FCPA)

Recent headlines have highlighted the dramatic surge in prosecutions being brought by the U.S. government under the Foreign Corrupt Practices Act (FCPA), which makes it illegal to bribe foreign officials. The U.S. Department of Justice (DOJ) and Securities and Exchange Commission (SEC) have specifically identified FCPA compliance as an enforcement priority, and a number of key corruption cases have surfaced during the anti-corruption M&A due diligence process[1].

Anticorruption enforcement also appears to be on the rise globally, with a number of countries becoming more aggressive in rooting out cross-border bribery. Authorities in different countries are cooperating more with U.S. regulators, increasing the importance of understanding the FCPA and anti-corruption related risk profile of potential M&A targets.

FCPA exposures that are not addressed may subject a buyer to successor liability for the seller's prior violations, which may create negative publicity and reputation damage, and diminish the value of the acquired company. The purchaser may also have to investigate and remediate corruption issues at significant costs and sometimes under the watchful eye of U.S. or foreign regulators.

[1] http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml

Every year, a significant number of potential buyers abandon what appear to be promising deals in emerging markets due to hints of FCPA infractions, such as bribes or other illegal payments to government officials. Whether the potential buyer is a corporation or a private equity firm, "they do not want to deal with a reputation issue," says Hernan Marambio, M&A Transaction Services Leader, Americas Financial Advisory, Deloitte & Touche LLP in the U.S. This regulatory roadblock is increasingly hard to avoid since everyday business functions in all industries, from building warehouses to exporting goods, typically involve government touch points.

One recent example of this conundrum: A U.S. multinational consumer products company planned to acquire a prominent foreign manufacturer and distributor. Working with an experienced forensic accounting team, the U.S. buyer discovered over USD$100,000 in suspicious payments to government officials at the target company, and record-keeping deficiencies that made it impossible to determine the actual purpose of these payments[2].

When the U.S. buyer sought an opinion on its potential FCPA liability from the DOJ, it learned that it would not be subject to successor liability. In fact, in the DOJ Opinion Procedure Release No. 14-02 ("DOJ Opinion 14-02"), the DOJ concluded that the potentially improper payments

[2] DOJ Opinion Procedure Release No. 14-02

were not subject to U.S. jurisdiction. The end result: the company had to establish policies and processes to ensure the target company's FCPA compliance post acquisition, but was able to purchase the target with no fear of FCPA-related repercussions resulting from the target company's historical activities. While FCPA violations are still a serious issue, DOJ Opinion 14-02 indicates that FCPA successor liability depends on the facts and circumstances and violations may not always be as problematic as they seem. In addition, DOJ Opinion 14-02 suggests that proactive and forthright acquirers may be able to avoid successor liability even when the DOJ does have jurisdiction over the target company.

In this article, we will focus on key steps for potential buyers to consider in their efforts to mitigate FCPA compliance risks, including successor liability, based on DOJ Opinion 14-02.

Situation 1: Past FCPA violations may exist, but they do not create successor liability

DOJ Opinion 14-02 highlighted a long-standing but often-forgotten fact: the DOJ generally does not have authority over companies that do not operate or issue securities in the U.S. In the particular case of the previously discussed U.S. consumer products company target, DOJ Opinion 14-02 states that none of the payments occurred in the U.S., and no U.S. person or securities issuer was identified as being involved. Additionally, no bribery-tainted contracts or assets would remain in operation post-acquisition to potentially benefit the U.S. acquirer.

DOJ Opinion 14-02 also states that if a U.S. securities issuer acquires 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." "Successor liability does not…create liability where none existed before."

In these circumstances, it's important to perform due diligence with an eye toward the future. Although a buyer may be free from FCPA successor liability, buyers should assess the potential impact of any benefits (such as customer contracts) that could be impacted or lost as the company modifies operating activities to be in compliance with the FCPA post-acquisition.

Situation 2: Past FCPA violations may exist, but they can be remediated to mitigate successor liability risks

While DOJ Opinion 14-02 expressly states that it applied only to the specific company that requested the opinion, the DOJ reiterated the following proactive steps that it encourages companies to undertake when engaging in mergers and acquisitions:

1. Conduct thorough risk-based FCPA and anti-corruption due diligence, taking into account all government touch points (e.g., permits, taxes, and customs) and related FCPA risks
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 the DOJ any corrupt payments discovered during the due diligence process

Past DOJ & SEC settlements with large companies that have encountered FCPA violations reinforce the importance of taking the proactive steps outlined above. In one deferred prosecution agreement with the DOJ, the company involved agreed to the steps above, as well as other specific terms regarding M&A, in addition to a much broader set of requirements, such as appointing compliance officers in each business unit. The company further agreed that it would ensure its own code of conduct is implemented "no less than one year post-closing" by the acquired entity and agreed to conduct an FCPA-specific audit of all newly-acquired businesses within 18 months of acquisition.

Need for help from specialists in assessing potential liabilities and related mitigation activities

While there's support for potential buyers and investors to be more optimistic about potential FCPA liabilities related to foreign acquisitions, mitigating liabilities and reputational damage risk still requires robust analysis and experience. The DOJ encourages potential buyers to conduct thorough anti-corruption due diligence and has prosecuted companies that only conducted cursory due diligence and subsequently identified on-going payments made to government officials by the seller post acquisition. This underscores the importance of utilizing experienced internal and external resources with appropriate knowledge of industry and local market bribery schemes. Often this entails engaging professionals who speak the local language, understand the local culture, and have access to in-country information that is often required to identify and evaluate the FCPA risks associated with the proposed transaction.

If a potential buyer still feels there is significant FCPA and anti-bribery risk related to the transaction after completing its due diligence, the potential buyer may want to request an opinion from the DOJ (similar to the opinion requested by the consumer products company in DOJ Opinion 14-02).

Conclusion

DOJ Opinion 14-02 provides a good example of why FCPA risks do not automatically translate into deal-breakers. However, potential buyers still need to exercise caution when it comes to foreign acquisitions, perform thorough due diligence, and make careful decisions regarding disclosures to the DOJ.

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