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DOJ Opinion Release 14-02 Highlights Importance of Pre-Acquisition Compliance Due Diligence (and Recognizes Its Limitations)

One of the most significant developments of 2014 in FCPA compliance arrived in November with the issuance by the Department of Justice of Opinion Procedure Release 14-02 (the "Opinion").[1] The Opinion stands for the proposition that the DOJ will not penalize a company subject to the FCPA for acquiring a foreign target with corruption issues, provided (a) the acquiring company did reasonable due diligence under the circumstances, (b) the company has an integration plan designed to implement real anti-corruption controls at the target post-closing, and (c) the company is not knowingly acquiring tainted contracts or other assets from which it will derive financial benefit going forward.[2]

As described in greater detail below, the acquiring company conducted pre-acquisition due diligence on the target with the assistance of outside counsel and forensic accountants. However, the target's lack of compliance policies and procedures, and the extremely poor quality of its recordkeeping and other financial controls, severely limited the acquiring company's ability to gain a complete picture of the compliance problems at the target. (It was apparent despite these limitations that a large number of improper payments had been made, as described further below.)

The acquiring company represented to the DOJ that, "based on its due diligence, no contracts or assets were determined to have been acquired through bribery that would remain in operation." The critical phrase here is "no contracts or other assets *were determined* to have been acquired through bribery…." The representation is thus not – and could not be under the circumstances – that no contracts or other assets were acquired through bribery. Rather, the acquiring company is representing that, after conducting reasonable due diligence under the circumstances, it was able to make no connection between any improper payment and any asset it was acquiring that would remain in operation post-closing.

The Opinion is thus highly significant for enabling a publicly listed U.S. company to acquire a foreign target, the anticorruption controls and financial

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

[2] The Release also confirms the non-controversial point that the mere acquisition of a foreign company not previously subject to the FCPA by a company that is subject to the FCPA will not create a basis for jurisdiction where none previously existed. Much of the published commentary on Opinion 14-02 has focused on this point – which was clearly established in the U.S. government's 2012 *Resource Guide to the U.S. Foreign Corrupt Practices Act* – to the exclusion of the other issues described herein.

records of which are so deficient that the acquirer has been unable to determine, even through reasonable, good faith diligence, whether tainted assets are being acquired. In providing this guidance, the DOJ has addressed at least partially the concerns M&A and compliance counsel have long had about successor liability in the acquisition context.

Background on Compliance and Successor Liability

Perhaps no transaction is more fraught with compliance risk, including anticorruption and other risks, than the acquisition of another company. Once a target is acquired, its risks are your risks, its problems are your problems, and its future is your future, for better *and* for worse. Even the most high-risk agents, consultants, and other service-providers can be terminated – with varying degrees of difficulty, depending on contractual protections, statutory requirements and other factors – if compliance risks are discovered. The unwinding of an acquisition or any other disposition of the acquired company or corporate assets is always difficult, however, and may in some circumstances be practically impossible or prohibitively expensive.

In the FCPA context, post-acquisition liability takes three main forms, one exposing the target company and two exposing the acquiring entity or "successor." First, U.S. authorities may prosecute the target company for improper payments to foreign government officials prior to the acquisition, provided there is a basis for U.S. jurisdiction.

This first basis for liability is clear. What troubles compliance counsel far more is the lack of clarity around successor liability, *i.e.*, the liability the acquiring company may face based on the pre-acquisition bad acts of the target.

There are two main bases for successor liability. First, if an acquiring company participates in or otherwise fails to halt misconduct after closing, then the government may pursue charges against the successor company directly. Second, and more controversially, the government may charge a company that has acquired assets tainted by bribery, including contracts, real estate, or other assets, if the DOJ believes the company knew such assets had been acquired by the target in whole or in part through bribery or if the company failed to perform due diligence that was adequate under the circumstances.[3]

[3] The "tainted assets" basis for successor liability is not stated clearly in any formal guidance issued by the DOJ, including the 2012 FCPA Guide as defined herein. Rather, this basis is grounded in prior DOJ enforcement actions and Opinion Procedure Releases.

In Opinion Release 01-01, for example, the DOJ based its no-enforcement posture on the assumption that contracts contributed by a foreign party to a joint venture were not acquired in violation of the FCPA and other applicable anticorruption laws. In *Latin Node*, the DOJ credited the acquiring company for terminating tainted contracts prior to the acquisition, further illustrating the DOJ's view that acquiring companies should not benefit from tainted assets, regardless of their lack of culpability in the improper payments that so tainted the assets.

The Department has also indicated that successor liability may attach to an acquiring company with regard to a tainted contract or other asset if the acquiring company takes some act in furtherance of the original improper payment. Such acts in furtherance may involve (i) paying a commission to an agent responsible for the improper payment (Opinion Procedure Releases 01-01 and 08-02); (ii) effectively reimbursing the target company and its owners, via the purchase price, for improper payments made in connection with the tainted assets (Opinion Release 08-02); and (iii) deriving economic benefit from the tainted assets following the acquisition (*SEC v. GE, Ionics and Amersham*, Complaint p. 17, para. B).

It is therefore critical to include compliance in the standard acquisition due diligence work plan. The DOJ and the Securities and Exchange Commission ("SEC") have made clear, including in their November 2012 *Resource Guide to the U.S. Foreign Corrupt Practices Act* (the "FCPA Guide"), that they expect companies to do everything possible in terms of due diligence prior to the acquisition or, to the extent pre-acquisition due diligence is not possible, to undertake a thorough compliance review promptly following the acquisition.

Experienced M&A counsel know the limits of even the most well-intentioned and thoughtful due diligence exercise. Deal lawyers and compliance counsel alike will therefore welcome the Opinion, which states the Department's intention not to pursue an FCPA enforcement action against a U.S.-based, publicly listed multinational corporation that identified, after a very challenging due diligence exercise, serious internal control deficiencies that enabled target company personnel to make a large number of apparently improper payments to foreign government officials but which made connecting any such payments to specific assets practically impossible.

Background on the Proposed Transaction

The DOJ issued the Opinion in response to a request for guidance from a U.S. consumer products company, a U.S. issuer, that intends to acquire a foreign target and one of the target's wholly-owned subsidiaries. In the course of its due diligence, the acquiring company identified "over $100,000 in transactions that raised compliance issues." These transactions included apparently improper payments made in connection with obtaining permits and licenses, as well as gifts and cash to government officials.

As noted above, the pre-acquisition diligence also revealed significant deficiencies in the target's business recordkeeping and internal accounting controls. For example, the "vast majority of the cash payments and gifts to government officials" were not supported by any documentation, and "[e]xpenses were improperly and inaccurately classified" in the target's books. As the Opinion recognizes, the acquiring company in this case was faced with the challenge of conducting diligence on a company whose "accounting records were so disorganized" that the accounting firm engaged to assist with the review "was unable to physically locate or identify many of the underlying records for the tested transactions."

DOJ Urges Pre-Acquisition Diligence and Disclosure

In 2012, the DOJ and SEC's FCPA Guide described compliance best practices in the context of mergers and acquisitions. Effective FCPA due diligence is among the most important steps a company is advised to take when contemplating an acquisition.

The FCPA Guide notes that companies that conduct effective due diligence are better able to evaluate a target's business risks and value. Companies that conduct thorough FCPA due diligence also "demonstrate to DOJ and SEC [a] commitment to compliance" that is "taken into account when evaluating any potential enforcement action." For example, the FCPA Guide notes that the DOJ and SEC declined to take enforcement action against an issuer when the company had "uncovered the corruption at the [target] as part of [pre-acquisition] due diligence, ensured that the corruption was voluntarily disclosed to the government, cooperated with the investigation, and incorporated the acquired company into its compliance program and internal controls."

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The Opinion specifically advises all companies engaging in mergers and acquisitions to follow many of the same steps, namely:

(1) conduct thorough risk-based FCPA and anti-corruption due diligence;

(2) implement the acquiring company's code of conduct and anti-corruption policies at the target level 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; and

(5) disclose to the DOJ any corrupt payments discovered during the due diligence process.

In the Opinion, the DOJ appears to take a pragmatic stance when dealing with companies that adopt a careful and reasonable approach to pre-acquisition diligence, post-acquisition integration, and cooperation with the government. In spite of the fact that the target's records and controls were so deficient that the acquiring company could not determine whether all of the assets and business it was acquiring had been obtained without corruption, the DOJ decided not to take any enforcement action with respect to known pre-acquisition bribery. Because the acquiring company was transparent about the serious, externally-imposed limitations on the scope of its review, its diligence and disclosures enabled the company to obtain some assurance that the misconduct it had uncovered would not lead to liability from the DOJ.