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Best practice for anti-corruption reviews in merger & acquisition transactions

When GE bought InVision Technologies in 2004 for US$900 million, they had no idea that they would be held accountable for US$2.69 million in civil and criminal fines, penalties and disgorgement for violations of the Foreign Corrupt Practices Act (FCPA) that occurred prior to the acquisition. This costly oversight could easily have been avoided had their legal team properly investigated the target for fraud or corrupt practices, but provides a solid lesson for other companies looking to acquire in Asia. It is critical that companies conduct thorough due diligence on their target in order to ensure they don't fall foul of the FCPA and other anti-corruption legislation.

In countries where the take-over code restricts due diligence or in the event of a hostile bid, the buyer should consult the authorities such as the US Department of Justice (DoJ) or the Serious Fraud Office (SFO) in the UK[1]. In 2008, Halliburton asked the DoJ for an opinion in relation to the hostile take-over of a UK company. Halliburton was given 180 days post acquisition to conduct a thorough due diligence, train staff, terminate and rewrite contracts with agents, customers and suppliers. And while there were strict milestones to meet, the DoJ conceded the company would not be held liable for FCPA violations that may have occurred prior to the acquisition[2].

Evaluating the integrity of your target – from an anti-corruption perspective

In order to protect your company from potential violations, the scope of the pre-acquisition due diligence from an anti-corruption perspective should include the following:

1. Conduct **integrity due diligence** on the targeted company and main office holders. This needs to be conducted by someone who has access to local sources of information and sufficiently strong local knowledge to interpret the information found. A reputation for illegal activity by a key individual will not in itself be probative of the company's ethics, but it does need to be taken into account when evaluating the M&A transaction as a whole.
2. Embed an **anti-corruption risk assessment** in the due diligence process. This should assess factors such as the prevalence of corruption within the industry and the country in which the target operates, how they interact with the government and their relationship with key customers, vendors and agents.
3. Perform a **forensic review** and actively seek to identify weak areas of internal control and questionable transactions using data mining tools. 'Red flags' such as financial results that are not consistent with expectations, unusual payment patterns or financial arrangements, substantial government interaction, high level of cash transactions, a refusal to certify compliance with the FCPA or other anti-corruption legislation, unusual commissions, or a lack of qualifications warrant further examination.

In addition to anti-corruption due diligence, purchasers should also include appropriate representations and warranties relating to compliance with anti-corruption laws in the transaction agreement, which should also contain a formal mechanism for post-closing remedies such as indemnification or purchase price adjustments.

M&A is a high-risk and expensive process, and incorporating procedures such as integrity due diligence, corruption risk assessments and forensic examination early in the due diligence process are critical to a successful acquisition and ultimately create shareholder value. Examples of corruption that surface after the acquisition only serve to harm the buyer's reputation, reduce shareholder value and jeopardise the transaction purpose.

Endnotes

1. Speech by SFO Director on 21 June 2011 is available at: http://www.sfo.gov.uk/about-us/our-views/director's-speeches/speeches-2011/breakfast-seminar-hosted-by-kingsley-napley--carmichael-fisher.aspx
2. The Opinion Release is available at: http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0802.pdf

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