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PERSPECTIVES

ANTI-CORRUPTION DUE DILIGENCE CAN HELP BUYERS, SELLERS AND THEIR ADVISERS TO FACILITATE ACQUISITIONS

BY **MICHAEL HUNEKE**

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Let's do more anti-corruption due diligence' is often an unwelcome proposal during pre-acquisition due diligence, if it is made at all. There is sometimes a reticence to stir up what are presumed will be unwelcome facts and often a significant burden on the seller to respond to a full array of anti-corruption questions from potential buyers. Yet thoughtful, risk-based anti-corruption due diligence can bring value to both sides of an acquisition and is best done earlier rather than later.

Pre-acquisition context

Pre-acquisition due diligence generally is not always as thorough as the buyer might wish. The target chooses what information to provide to the potential buyer and when to provide it. The buyer does not have subpoena or police power over the target. A buyer's ability to conduct pre-acquisition due diligence might also be limited where there is competition from other potential buyers or there are timing constraints that affect the scope and

depth of available pre-acquisition due diligence. Pre-acquisition due diligence in practice becomes an effort to ascertain as much as reasonably possible regarding value and risks before finalising the acquisition.

Enforcement context

US law does not retroactively create pre-acquisition jurisdiction over the seller's historical conduct if the seller was not subject to US jurisdiction. Yet for a buyer that is subject to US Foreign Corrupt Practices Act (FCPA) jurisdiction, the acquisition will pull the target's post-closing operations and revenue streams into the FCPA's jurisdiction. For buyers not subject to FCPA jurisdiction that acquire a target business that is subject to FCPA jurisdiction, the value of the target business could be significantly impacted by pending or future US investigations, in addition to bringing unwelcome scrutiny of the buyer.

US enforcement authorities recognise that there are practical limitations on pre-acquisition anti-corruption due diligence, and that there is a benefit to global anti-corruption efforts when buyers with strong compliance programmes acquire and integrate sellers with weak – or non-existent – programmes. These authorities, however, also stress the importance of whether a company integrates anti-corruption due diligence into M&A activity. This

factor is relevant to their decision whether to hold companies accountable for misconduct by their employees.

Unfortunately, there are no bright lines delineating how much pre-acquisition due diligence on corruption topics is enough. Instead, US enforcement

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guidance sets an expectation that companies will make reasonable efforts to conduct pre-acquisition due diligence. In practice, this typically includes making document requests relevant to potential corruption risks, reviewing materials in the data room, asking follow-up questions about potential compliance risks, and speaking with the target about corruption risks.

How anti-corruption due diligence helps buyers

Pre-acquisition anti-corruption due diligence provides several advantages to buyers. The buyer

can better evaluate whether certain revenue streams should be discounted in estimating the going-forward value of the target business.

The going-forward value might be reduced because of corruption, or simply because there are significant risks of corruption that will require the buyer's time and effort to analyse and mitigate as part of the buyer's integration of the target into the buyer's compliance programme. Knowing this in advance allows the buyer to forecast more accurately the value of the business and the post-closing integration costs.

The buyer might rely on these risks and costs to negotiate the purchase price down, although the buyer's ability to do so is limited where there are competing buyers, whether through an auction sale or otherwise.

The buyer will be able to use the corruption risks identified to seek protections in the form of representations and warranties (R&W) in the purchase agreement. A buyer that obtains these protections and then seeks R&W insurance (RWI) will likely receive questions from the insurance provider regarding the anti-corruption due diligence performed and whether the seller has an anti-corruption compliance programme on which the seller's representations could reliably have been based. The insurance provider will have its own counsel, and the anti-corruption questions can be quite detailed.

Anticipating these questions helps the buyer to avoid unnecessary delays in obtaining RWI coverage. If the provider perceives that the seller has a weak or non-existent compliance programme, however, the provider is likely to exclude the seller's anti-corruption R&W from coverage, either completely or for certain countries or business lines. In that case, the buyer can then seek other protections (e.g., indemnifications).

Finally, a buyer that discovers corruption by the seller could attempt, pre-closing, to demand that the seller voluntarily disclose the corruption to the relevant authorities. This option might not be available in practice, however, if there are competing buyers, and it will significantly delay the deal. But where the buyer has leverage over the seller, this option could allow the buyer to complete the acquisition with the benefit of knowing a final determination of the financial and business impact of the related enforcement activity.

How anti-corruption due diligence helps sellers

The benefits of pre-acquisition anti-corruption due diligence are not one-sided. Sellers, too, can leverage such due diligence to their advantage.

Primarily, the seller's design and implementation of an anti-corruption due diligence process can help demonstrate the continued viability of revenue streams post-acquisition. Sellers that have already implemented such a process can give buyers



comfort that reasonable, risk-based anti-corruption due diligence is already being undertaken, to attempt to negotiate down the scope of buyers' anti-corruption due diligence questions and enhance the likelihood that a buyer could obtain RWI coverage.

Sellers can pre-emptively undertake their own anti-corruption due diligence. Such a 'voluntary' due diligence (VDD) allows the seller an opportunity to frame the initial narrative around its anti-corruption efforts, and, if warranted, gives the seller an opportunity to implement process enhancements to demonstrate to potential buyers the seller's efforts to reduce corruption risks.

Finally, sellers whose consideration includes an earn-out tied to post-closing revenue targets can avoid having those targets set unreasonably, if the buyer's due diligence programme is likely to cause disruption or even termination of third-party relationships that might adversely affect future business – either because of corruption, or because the seller's third parties might not be prepared to quickly satisfy a buyer's more stringent anti-corruption due diligence process.

Sellers with no compliance programmes

Even sellers with no compliance programmes can benefit from undertaking anti-corruption due diligence. Conducting an initial assessment of corruption risks, such as a 'desktop' review of basic information already available (as opposed to a questionnaire- and interview-based assessment across the seller's business), could potentially help the buyer and seller to focus on the seller's most-significant corruption risks.

Additionally, if the seller relies on agents or other third parties to obtain or retain business, a buyer's first due diligence questions will include a request for a list of all third parties used over a period of several years, the third parties' country of registration, the identity of their ultimate beneficial owners and copies of agreements with third parties. Responding to such requests can take significant time and effort.

Anticipating these questions can allow for a more thoughtful, deliberate evaluation, and might provide the seller with the opportunity to end third-party relationships that would not survive due diligence review.

How investment bankers can help prepare sellers

The investment bankers or brokers facilitating the acquisition can help to minimise the impact that anti-corruption due diligence has on deal timing.

These advisers should educate sellers about how buyers' anti-corruption due diligence can affect deal value and timing. They should also include anti-corruption due diligence among the steps sellers should take to obtain maximum value for their business. Even taking the initial steps of assessing corruption risks and cataloguing the seller's use of third parties can go a long way toward reducing later delays.

The typical confidential information memorandum and management briefing presentations prepared by these advisers should include information describing the seller's compliance programme (or steps being undertaken to develop one) and clearly explain the seller's use of third parties to obtain or retain business. When these documents use inconsistent or confusing terminology for the seller's third parties or how the seller obtains sales, there is a risk that buyers and buyers' advisers will form a negative first impression of the corruption risks and the

reliability of revenue projections. Finally, if the seller is obtaining VDD reports from its own advisers, there should be a VDD report that includes a general discussion of the seller's compliance programme and specific information about the seller's anti-corruption due diligence on third parties.

Conclusion

As with many compliance topics, regulators' anti-corruption compliance programmes and due diligence expectations are a one-way ratchet, always increasing and never decreasing. US authorities have placed significant importance on the integration of anti-corruption compliance into M&A processes.

While regulators understand the practical limitations on the extent of pre-acquisition anti-corruption due diligence that might be possible, both sides to a transaction can benefit from the early application of reasonable, risk-based anti-corruption due diligence on the seller's business. Rather than a topic to be avoided, there is value in embracing anti-corruption due diligence and, given regulators' and insurance providers' focus on the topic, little practical ability to avoid it. **RC**



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