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EXPECTATIONS AND PRACTICALITIES OF ANTI-CORRUPTION DUE DILIGENCE THROUGH ETHICS & COMPLIANCE INTEGRATION

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What Is Successor Liability?

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What Is Successor Liability?

Company A acquires Company B.

Post acquisition, Company A learns that Company B's employees paid bribes to foreign government officials.

Company A is then subject to a post acquisition enforcement action for these earlier Foreign Corrupt Policies Act (FCPA) violations.

This is "successor liability"…

Halliburton Opinion (2008)

- In connection with a potential deal, Halliburton sought an opininion letter from the DOJ as it was concerned about potential successor liability as local law prevented Halliburton from conducting preacquisition due diligence of the target
- The DOJ's Opinion Letter was very specific and was instructive for years related the timeline for due diligence, including:
  - Within 10 days of closing, have a detailed anti-corruption work plan
  - Immediately begin diligence post-closing with an expectation that reporting out begins within 90 days after closing and concludes within 180 days
  - Remediate all uncovered issues within Year One
- The Opinion Letter also made it clear that Halliburton should implement its own anticorruption program within the target, which includes training all of the employees of the target
- And finally, there is an expectation that the company be ready to disclose any uncovered issues

Prior Case Examples:
Goodyear , $16.2 Million (2015)

- Goodyear settled charges with the SEC relating to $3.2 million in illicit payments made by two subsidiaries from 2007-2011
- In Kenya, Goodyear acquired a majority interest in a tire distributor, but that distributor continued to be run by its founders. The local general manager subsequently paid $1.5 million in bribes by approving checks made payable to cash for phony promotional products
  - Goodyear failed to detect these bribes because it "failed to conduct adequate due diligence when it acquired [the distributor], and failed to implement adequate FCPA compliance training and controls after the acquisition"
- In Angola, the former general manager of Goodyear put in place a bribery scheme that resulted in $1.6 million in bribes being paid in the four years after the acquisition, from funds generated in ledger accounts, by adding phony freight and customs clearing charges to invoices

Zimmer Biomet Holdings, Inc. (2017)

- Biomet, having originally paid $23 million to resolve violations of the FCPA in 2012, was subsequently acquired by Zimmer, which was then hit with an additional **$30 million** and new three-year DPA.
- Even after the 2012 DPA between the DOJ and Biomet, the company knowingly and willfully continued to use a third-party distributor in Brazil known to have paid bribes to government officials on Biomet's behalf. Biomet also failed to implement an adequate system of internal accounting controls at the company's subsidiary in Mexico, despite employees and executives having been made aware of red flags suggesting that bribes were being paid.

Mondelēz $13 Million Resolution (2017)

- Mondelēz acquired Cadbury in 2010, including Cadbury's Indian subsidiary
- Cadbury India failed to conduct due diligence or monitor an agent retained preacquisition to help obtain licenses and approvals for a proposed plant, creating "the risk that funds . . . could be used for improper or unauthorized purposes"
  - That agent submitted invoices for preparing and submitting licenses, but Cadbury's employees actually prepared those license applications
  - Cadbury had no written contract with the agent, and had no additional documentary support for the agent's services
- Mondelēz was unable to complete preacquisition due diligence – Mondelēz conducted "substantial, risk-based, post-acquisition" diligence, but failed to identify the relationship with this agent
- Cadbury ultimately paid the agent ~$90,000 to obtain licenses and approvals for a proposed plant in India, but its books and records failed to accurately and fairly describe the services provided

Kinross Gold (2018)

- Kinross Gold (KG), a Canadian mining company with shares traded on the NYSE, acquired two mines from a Vancouver-based mining company in 2010 for $7.1 billion
- KG performed due diligence prior to the acquisition, which identified that the parent company and mines lacked anti-corruption compliance programs/internal accounting controls
- Despite knowing that the mines lacked adequate compliance programs it took nearly three years for KG to implement adequate controls, that it then failed to properly maintain
- Post acquisition in 2011, KG's internal audit group recognized that the mines lacked internal accounting controls surrounding vendor selection, contracting, and disbursements, but management failed to take immediate action to correct these deficiencies
- After KG implemented compliance controls in 2013, it failed to follow those controls on at least two occasions and later settled allegations with the SEC that it failed to implement proper accounting controls in two mining subsidiaries in Ghana and Mauritania

"Bankrate Inc.'s Successor in Interest Agrees to Pay $28 Million to Resolve Securities and Accounting Fraud Charges" (2019)

- Baton Holdings LLC, as the successor in interest to Bankrate Inc., a financial services and marketing company (Bankrate), entered into a nonprosecution agreement and agreed to pay **$28 million** in combined monetary penalties and restitution to resolve the government's investigation into a complex accounting and securities fraud scheme carried out by former executives of Bankrate.
- Bankrate admitted that former executives engaged in a complex scheme to artificially inflate Bankrate's earnings through so-called "cookie jar" or "cushion" accounting, whereby millions of dollars in unsupported expense accruals were purposefully left on Bankrate's books and then selectively reversed in later quarters to boost earnings.
- In addition, Bankrate admitted that former executives misrepresented certain company expenses as "deal costs" in order to artificially inflate publicly reported adjusted earnings metrics, and also made materially false statements to Bankrate's independent auditors to conceal the improper accounting entries.
- Bankrate admitted that the fraudulent conduct caused Bankrate's shareholders to suffer at least $25 million in losses.
- According to the resolution documents, Red Ventures Holdco LP, which acquired Bankrate in November 2017 after the securities and accounting fraud scheme took place, also agreed to certain terms and obligations under the agreement but had no involvement in the underlying criminal conduct.

TechnipFMC plc (2019)

- TechnipFMC plc (TFMC), a publicly traded company in the United States and a global provider of oil and gas services, and its wholly owned US subsidiary, Technip USA, Inc. (Technip USA), entered DPA and paid **$296 million** to resolve foreign bribery charges with authorities in the United States and Brazil.
- TFMC is the product of a 2017 merger between two predecessor companies, Technip S.A. (Technip) and FMC Technologies, Inc. (FMC). The charges arose out of two independent bribery schemes: a scheme by Technip to pay bribes to Brazilian officials and a scheme by FMC to pay bribes to officials in Iraq.

Regulator Expectations Around Anticorruption Due Diligence is Clear (well, almost)

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FCPA Resource Guide, Second Edition (2020)

- Focusing specifically on successor liability in the FCPA context, the Resource Guide encourages "companies to conduct preacquisition due diligence and improve compliance programs and internal controls" as it:
  - Enables a more accurate value of the target (i.e., if sales contracts were won through bribes, then assume a decrease in the value)
  - Reduces the risk of continued bribes at the target
  - Allows the parties to negotiate who bears the responsibility for any investigation and/or remediation efforts
  - "demonstrates a genuine commitment to uncovering and preventing FCPA violations"

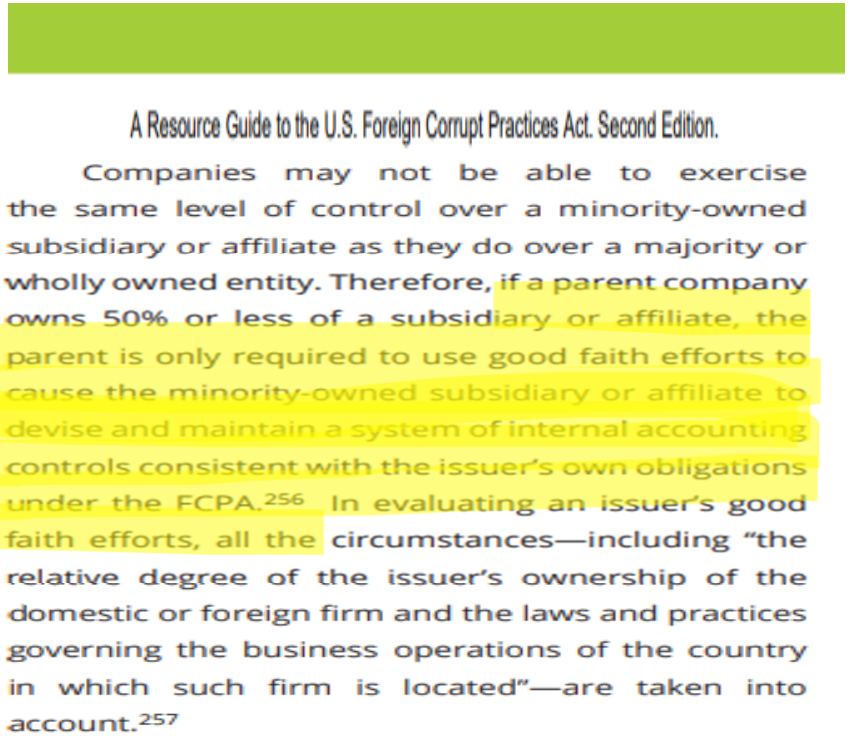
- But importantly, the "*DOJ and SEC also recognize that, in certain instances, robust pre-acquisition due diligence may not be possible. In such instances, DOJ and SEC will look to the timeliness and thoroughness of the acquiring company's post-acquisition due diligence and compliance integration efforts.*"

FCPA Corporate Enforcement Policy

- *M&A Due Diligence and Remediation*: The Department recognizes the potential benefits of corporate mergers and acquisitions, particularly when the acquiring entity has a robust compliance program in place and implements that program as quickly as practicable at the merged or acquired entity. Accordingly, **where a company undertakes a merger or acquisition, uncovers misconduct by the merged or acquired entity through thorough and timely due diligence or, in appropriate instances, through post-acquisition audits or compliance integration efforts, and voluntarily self-discloses** the misconduct **and otherwise takes action consistent with this Policy** (including, among other requirements, the timely implementation of an effective compliance program at the merged or acquired entity), there will be a **presumption of a declination** in accordance with and subject to the other requirements of this Policy.

- Justice Manual 9-47.120

Are you liable even when you have minority ownership?



A Resource Guide to the U.S. Foreign Corrupt Practices Act. Second Edition.

Companies may not be able to exercise the same level of control over a minority-owned subsidiary or affiliate as they do over a majority or wholly owned entity. Therefore, if a parent company owns 50% or less of a subsidiary or affiliate, the parent is only required to use good faith efforts to cause the minority-owned subsidiary or affiliate to devise and maintain a system of internal accounting controls consistent with the issuer's own obligations under the FCPA.[256] In evaluating an issuer's good faith efforts, all the circumstances—including "the relative degree of the issuer's ownership of the domestic or foreign firm and the laws and practices governing the business operations of the country in which such firm is located"—are taken into account.[257]

What does this mean in practice?

Key Takeaways

- Even effective due diligence is insufficient if there is a lack of follow-through postacquisition
- Timing is critical; must act to stop ongoing violations from continuing post-acquisition as quickly as possible
  - History shows that SEC and DOJ will not overlook postacquisition violations simply because the practice began preacquisition
  - For non-US targets, acquisitions do not create FCPA liability for prior violations where the United States previously lacked jurisdiction (DOJ Opinion Procedure Release No. 14-02)
  - Postacquisition violations are typically not covered by DOJ's Corporate Enforcement Policy Re M&A Due Diligence and Remediation

The Practicalities of Due Diligence & Integration

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Combined, Very Explicit Expectations around M&A

Bringing greater emphasis to:

- The need for compliance programs to be "adequately resourced and empowered to function effectively."
- The evolution of compliance programs based upon lessons learned, measuring the effectiveness of training and the appreciation of risk.
- The compliance function's ability to access relevant sources of data in a timely way.
- **How effectively a company has integrated acquired operations into its compliance structures and controls.**
- The accessibility of policies and training on those policies.
- The awareness of hotline reporting, and investigative processes to follow up and remediate.

An effective compliance program thus focuses on pre-close due diligence and post-close acquisition risk assessment and integration activities to (a) identify any issues and (b) implement controls to detect and prevent it in the future.

Everyone Is Doing Some Level of Preacquisition Anticorruption Due Diligence, Right?

- Ideally, ethics and compliance has the ability to obtain enough information from the target to assess:
  - Whether the target has an ethics and compliance program in place (e.g., the Code of Conduct (Code), training, helpline, investigations processes)
  - Whether the target has an anticorruption program in place (e.g., anticorruption policy, gift and entertainment process and procedure, third-party due diligence program, training and awareness campaign)
  - What high-risk touchpoints exist at the target (e.g., government clients, use of intermediaries, offices in high-risk countries that could create operational risk)
  - Whether high-level transaction testing (TT) identifies any significant red flags via T&E review (gifts and entertainment, charitable or political contributions, sponsorships)
  - Who the target's high-risk third parties are, what the contracts say, and whether they have gone through any type of due diligence

Transaction Testing (Preacquisition or Postclose)

Transactions testing by reviewing:

- High-risk G/L accounts (permitting, consulting fees, entertainment expenses)
- Vendor and third-party payments
- Petty cash transactions
- Cash advances

With a focus on:

- Highest transaction amounts
- Round dollar/currency amounts
- Transactions with duplicate dates
- Transactions with duplicate document/invoice numbers
- G/L descriptions

But That Doesn't Always Happen…

- Every deal has its challenges, whether it be:
  - A competitive bid with a fast timetable
  - A target with very few people under the tent who don't know how or where to find the data you need
  - Privacy or security limitations on access to information
  - A target that doesn't understand what's being requested, or doesn't care if it complies
- These things happen even though the government assesses whether a company has an effective compliance program by asking: "Does the company enable comprehensive preacquisition due diligence of targets?" See Evaluation of Corporate Compliance Programs (June 2020), page 9; A Resource Guide to the US Foreign Corrupt Practices Act, Second Edition, page 66.
- So, what should you do?

As Close to Day One as Possible

- Remember, the expectation is that the entire compliance program in timely integrated: this includes the Code, policies, training, communication, the reporting hotline and investigations…
- Welcome your new employees! Ensure that Senior Management is engaged and is setting the tone around ethics and compliance during this first impression meeting.
- Send a message to all new employees highlighting the importance of acting ethically, including links to the Code, corporate policies, and procedures. Provide details on the company's hotline and the company's commitment to nonretaliation.
- Assign training. Train not just on the Code of Conduct but include a high-level course on anticorruption. Ensure that targeted, detailed anticorruption training is given to high-risk employees.
- Communicate continuously.
- Ensure that your investigations process is fully integrated.

Other Integration Work

- If you are lucky enough to acquire a target with a substantially similar anticorruption program, outline steps to begin monitoring its implementation and effectiveness
- If not, devise a risk-based risk assessment that is informed by due diligence and includes:
  - Additional TT (or in some cases, the start of TT)
  - Interviews to better understand the program and how government touchpoints are managed, and to get answers to any suspect transactions identified through TT
  - Completion of screening and due diligence on all identified high-risk third parties
  - Plans to conduct an audit 12-18 months postclose

Acquired-company Third Parties

- Guidance is clear that you need to conduct anticorruption due diligence on your third parties as soon as possible
- Guidance presupposes the existence of a current and accurate master vendor list, and centralized knowledge of what those vendors do for the target, where those vendors operate, and the contract terms governing those relationships. But that is rarely the case…
- Start somewhere. Seek list of high-risk anticorruption vendors during preacquisition due diligence and, if the target doesn't have that list (likely), ask for all vendors who are involved in certain high-risk activities. This takes time and effort…
- Is there a coordinated effort to conduct holistic due diligence on the third parties? Should there be?

Acquired-company Third Parties

- For existing third parties, rationalize that list
  - Do we already do business with that vendor? If so, can we adapt our contract terms and relationship?
  - Do we have a vendor onboarded who can do the work of that vendor going forward?
  - This should narrow your due diligence on the remainder, but ensure that you have ownership at both the target and your company for that relationship to move due diligence forward in a timely manner
- For any third parties newly proposed for use by the target, ensure integration into your existing third-party process, understanding that you may have both systems and resource limitations. This is where coordinated, holistic due diligence across all risk areas will inure to your benefit…

These Expectations Are Not Limited to FCPA Risk

- Acquisitions create risk for companies across myriad issues
  - Cybersecurity
  - Privacy liability
  - Fair labor standards and human rights issues
  - Anticompetition
  - Intellectual property
  - Not to mention ESG issues (that's a separate CLE, by the way)
  - And regulations for highly regulated businesses
- So, if your M&A process does not include your risk functions, it should be so that risk-based due diligence activities are occurring systematically and that timely integration of all internal controls occurs holistically

Some Interesting Dilemmas

- Where there is a longer integration period companies often enter into transition services agreements, but you need to think about the following in those instances:
  - What if there is a data breach? Are you wholly reliant on the seller to manage the breach, including providing you with information needed to make timely notifications? Are you okay with that?
  - Do you have assurances that its monitoring plans are sufficient? Is it monitoring for data leakage that matters to you (for your IP, confidential information)? Are its surveillance practices substantially similar to your controls and expectations? What if they aren't?
- What about emerging reporting? Has the target been disclosing information related to ESG issues (DEI or Climate)? Do you want that to continue, or should it be subsumed in your own ESG disclosures? If the former, are its levels of disclosure consistent with your own? How do you audit the information for accuracy prior to disclosure?

Key takeaways

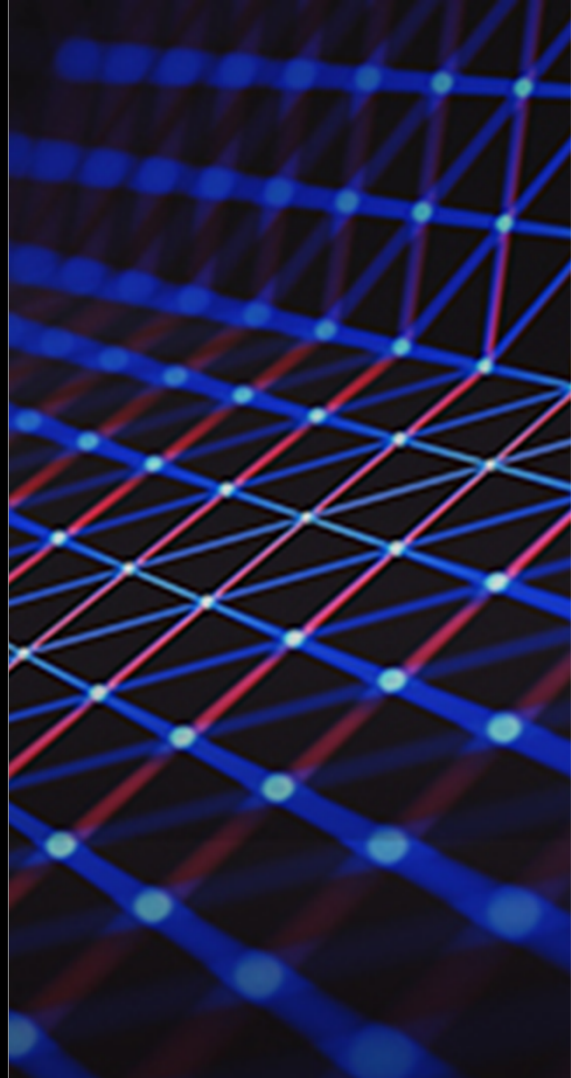
- Ensure Ethics & Compliance has a seat at the table in M&A
- Have a plan and execute against it in a timely manner
- Be ready to disclose, if you need to
- There is a public policy interest, which is recognized by the DOJ, in having strong US MNCs acquiring “bad companies” and then “cleaning them up”

Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at **www.morganlewis.com/topics/coronavirus-covid-19**

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to **subscribe** using the purple "Stay Up to Date" button.



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Sandra brings to her practice the experience as former chief of the DOJ's Fraud Section in Washington, DC, which has exclusive jurisdiction over the FCPA and routinely handles many of the world's most significant economic crime cases. An experienced trial lawyer, she represents companies and executives in a wide range of matters involving the US DOJ, the SEC, US Congress and various other domestic and international enforcement agencies. As chief of the Fraud Section, Sandra led a team of more than 150 white collar prosecutors and oversaw the FCPA Unit, as well as the section's healthcare, securities, and financial fraud prosecutions. She led, negotiated, or approved dozens corporate enforcement resolutions, including global coordinated resolutions involving multiple domestic and foreign authorities, and played a key role in the selection and oversight of corporate monitors. Sandra also helped develop and implement significant policy changes affecting corporate criminal enforcement throughout the DOJ, including the FCPA Corporate Enforcement Policy and various reforms to the Justice Manual. Sandra has been recognized as one of Top 100 Women in Investigations by Global Investigations Review (GIR) in 2018.

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Amy is a litigator who focuses on corporate ethics and compliance counseling, internal and government investigations, and mergers and acquisitions due diligence and integration, particularly in the technology and life sciences sectors. She builds, enhances, and streamlines corporate compliance programs, as well as global anti-corruption and investigations programs. Amy, a former senior vice president and chief ethics and compliance officer at a major information technology company, supported the company's active M&A profile during due diligence and integration. She also enhanced its corporate ethics and compliance program, and worked closely with the US Department of Justice and US Securities and Exchange Commission in connection with the company's on-going reporting requirements related to an FCPA resolution. Prior, Amy was the executive director of global investigations for a major international pharmaceutical company, where she enhanced the company’s compliance program, specifically as it related to its corporate policies and procedures and its global anti-corruption compliance program. Previously, in 2008, Amy was tapped to create a corporate compliance program for a Fortune 10 company.

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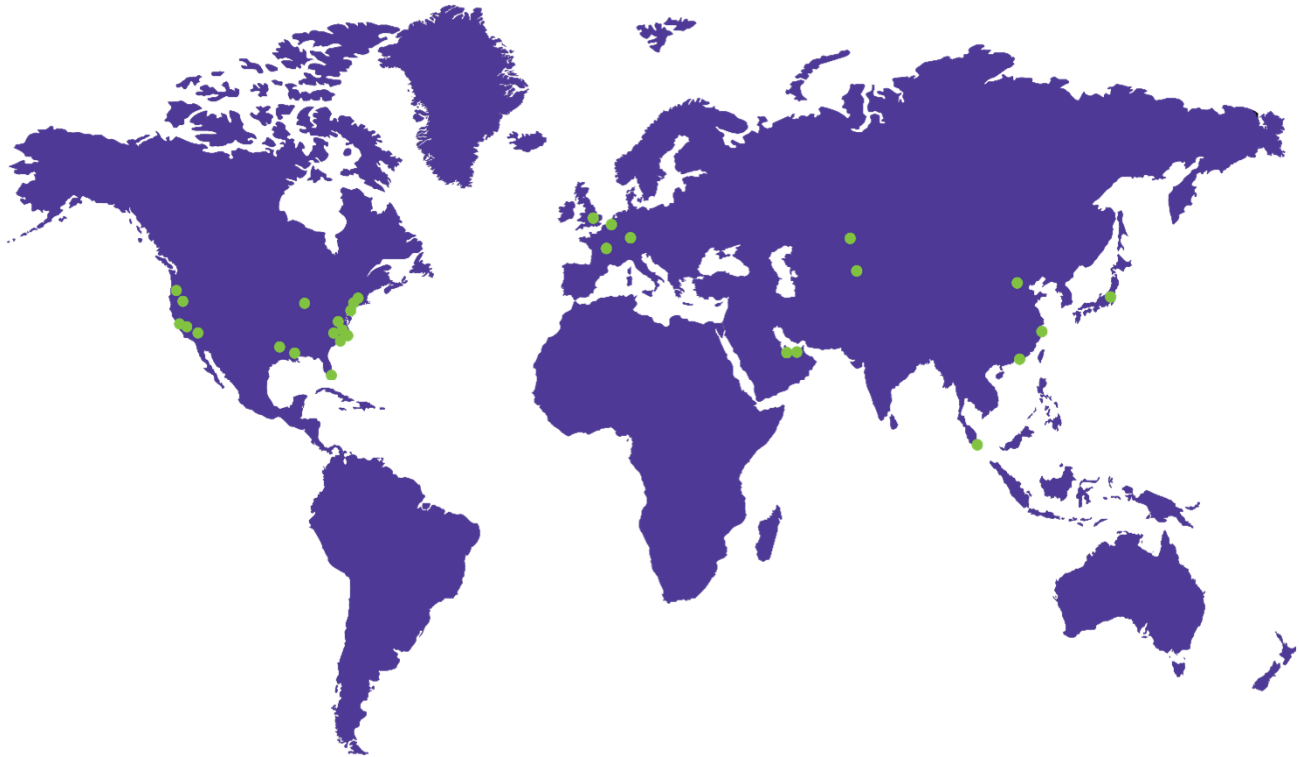

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THANK YOU