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FCPA Successor Liability: Due Diligence and Integration Are Key

On November 7, 2014, the U.S. Department of Justice ("**DOJ**") issued a Foreign Corrupt Practices Act ("**FCPA**") Opinion (Opinion Procedure Release 14-02) providing guidance to companies seeking to identify and mitigate risk relating to the acquisition of foreign targets. First, Release 14-02 reiterates previous guidance that a company's acquisition of a foreign target that was not historically subject to the FCPA does not retroactively create FCPA liability that did not previously exist. Second, the Release repeats DOJ's longstanding position that pre-closing diligence and post-closing remediation are the key to responsibly integrating targets and avoiding post-acquisition FCPA issues. While both of these points are consistent with generally understood practice regarding the acquisition of foreign targets, DOJ's acknowledgement that each transaction is different reinforces the argument for tailored, risk based assessment and mitigation of FCPA risk before and after closing.

Background

The DOJ Opinion procedure allows U.S. issuers of securities and other U.S. companies to obtain an official opinion whether specific conduct would result in an enforcement action under the anti-bribery provisions of the FCPA. The request for an opinion must be set forth in writing, accompanied by relevant evidence, and signed by a responsible corporate executive.

Opinion Procedure Release 14-02 responds to an inquiry by a U.S.-headquartered multinational issuer of U.S. securities (the "**Requestor**") regarding its anticipated 100% share acquisition of a target company and its subsidiary (the "**Target Company**"), a consumer products company incorporated and operating outside the United States. Pre-acquisition due diligence, which included engaging an experienced forensic accounting firm to assess the Target Company's books and records, revealed numerous compliance red flags. First, the diligence identified over $100,000 in improper payments suggesting the Target Company had engaged in bribery of foreign government officials. The majority of these involved payments to government officials to obtain permits and licenses. Others involved gifts and cash donations to government officials, charitable contributions and sponsorships, and payments to members of the state-controlled media to minimize negative publicity. The diligence also revealed significant recordkeeping deficiencies, including the inaccurate recording of payments in the company's books and lack of payment documentation. Finally, the diligence revealed that the Target Company lacked written compliance policies and procedures and that its personnel did not appear to be aware of anti-bribery laws.

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The diligence did not identify any pre-acquisition conduct that was subject to the jurisdiction of the United States. The Requestor sought assurance that DOJ would not bring an FCPA enforcement action against Requestor for the Target Company's pre-acquisition conduct.

DOJ's Intent Not to Take Enforcement Action

In Release 14-02, DOJ stated that it did not intend to take enforcement action against the Requestor for pre-acquisition bribery committed by the Target Company. DOJ emphasized the lack of any U.S. jurisdictional nexus to the pre-acquisition conduct: the Target Company's shares were held almost exclusively by another foreign corporation (the "**Seller**"), which is listed on a foreign stock exchange; neither the Seller nor the Target Company is or has been a U.S. issuer; the Seller's and the Target Company's operations are largely confined to a foreign country, with negligible business contacts in the United States; and none of the payments, gifts, donations, contributions, or sponsorships occurred in the United States or were made by or through a U.S. person or issuer.

In explaining its decision, DOJ observed that its previously published guidance on successor liability "squarely addresses the situation at hand." In this guidance -- *FCPA – A Resource Guide to the U.S. Foreign Corrupt Practices Act* (2012) (the "**Guide**") -- DOJ and the Securities Exchange Commission ("**SEC**") stated that "[s]uccessor liability does not . . . create liability where none existed before. For example, if an issuer were to acquire 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 for the acquiring issuer." An example provided in the Guide regarding the potential successor liability of hypothetical "Company A" mapped perfectly onto the Requestor's circumstances. In assessing the potential acquisition of a foreign company, the Guide stated that "[a]lthough DOJ and SEC have jurisdiction over Company A because it is an issuer, neither could pursue Company A for conduct that occurred prior to the acquisition of Foreign Company. As Foreign Company was neither an issuer nor a domestic concern and was not subject to U.S. territorial jurisdiction, DOJ and SEC have no jurisdiction over its pre-acquisition misconduct." FCPA Guide, at 31. Based on this guidance, DOJ stated in the Release that it had no intent to pursue an enforcement action for the pre-acquisition conduct of the Target Company.

Analysis and Lessons

Given DOJ's prior guidance and basic principles of corporate law, this decision should have been a "no brainer." The fact that the Requestor felt it necessary to go through the Opinion Procedure Release process (which took over six months) speaks volumes about the current FCPA enforcement climate. As DOJ noted, "[i]t is a basic principle of corporate law that a company assumes certain liabilities when merging with or acquiring another company," through principles of successor liability. Companies have been badly burned by latent liabilities in prior transactional cases – in fact, in one case a company lost the entire value of the acquisition due to pre-existing liabilities it did not identify during diligence. *See* Criminal Plea Agreement, Latin Node, Inc., Case No. 09-20239 (Apr. 3, 2009), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/litton-applied/04-03-09latinnode-plea-agree.pdf. Given this risk, the Requester perhaps cannot be faulted for seeking formal assurance that it was not buying a liability bomb.

The Release also includes an important reservation, however. Among the Requestor's representations cited in support of its decision, DOJ noted that "Requestor also represents that, based on its due diligence, no contracts or other assets were determined to have been acquired through bribery that would remain in operation and from which Requestor would derive financial benefit following the acquisition." This caveat is somewhat puzzling. If DOJ lacked jurisdiction over the Target Company when any bribery occurred, and if the Target Company was not acting as the Requestor's agent at the time, then by DOJ's own logic no FCPA liability should attach to contracts or assets that were acquired through pre-acquisition conduct over which DOJ lacked jurisdiction, absent post-acquisition improper conduct. DOJ may be reserving space for some theory of continuing or post-

acquisition liability; but at the very least it appears that this reservation qualifies some of the certainty the Opinion Release otherwise gave.

Finally, the Release emphasized the importance of conducting due diligence and integrating a target into an acquiring company's compliance controls after the acquisition. DOJ observed at the end of the Release that it would consider a number of factors in determining "whether and how . . . to impose post-acquisition successor liability in the case of a putative violation."[1] These factors include:

1. Conducting thorough risk-based FCPA and anti-corruption due diligence;
2. Implementing the acquiring company's code of conduct and anti-corruption policies as quickly as practicable;
3. Conducting FCPA and other relevant training for the acquired entity's directors and employees, as well as third-party agents and partners;
4. Conducting an FCPA-specific audit of the acquired entity; and
5. Disclosing to DOJ any corrupt payments discovered during the due diligence process.

DOJ and the SEC have articulated these factors on numerous prior occasions, including in the Guide. Importantly, the Release recognizes that "[t]he circumstances of each corporate merger or acquisition are unique and require specifically tailored due diligence and integration processes." Companies should take appropriate efforts to conduct risk-based diligence tailored to their acquisitions and to prioritize the integration of acquired entities into their compliance function to identify and remediate corruption risks before they become fodder for post-acquisition enforcement action.

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[1] DOJ's use of the term "successor liability" here also is puzzling. As DOJ stated in the Release that successor liability would not exist, the more appropriate term would be simple "liability" for post-acquisition violations.