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Structuring A Compliant Cross-Border Transaction

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The role for chief compliance officers, general counsel, financial and accounting professionals during proposed mergers, acquisitions and dispositions of assets has expanded in recent years as greater public law, policy and enforcement activity is required to ensure that a contemplated transaction is compliant and that the risk management of environmental, health, safety and reputational risks is a disciplined and well documented component of the due diligence process associated with a deal. Behind the headlines when a proposed transaction is announced, there is a widening range of stakeholders from regulators to activist shareholders to board members who expect that the due diligence process will limit risk significantly.

The Legal Perspective

Many transactions today are cross-border or at least have an international component to part of the deal. Recognition, analysis and management of geopolitical risks is essential to the effectiveness of deal due diligence in such transactions. Several critical success factors must be considered when going global:

Understanding The Compliance Universe

In a cross-border deal or in the analysis of significant international operations, the number of and interaction between numerous regulatory frameworks may be an important consideration. While one set of legal and regulatory requirements may be over-arching, key considerations related to



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regimes which are more or less rigorous, may require careful analysis to understand what combination of operational, performance and reputational risks may be triggered by practices outside the 'home' country.

Appreciating Cultural Nuances

In many developing markets the line between bribery or corruption and ethical business practices is not always as clear as it may appear in a fully developed economy. Understanding the actions of employees and agents of a target company clearly and determining how those actions may be perceived by regulators at home is a critical step in today's due diligence.

Recognizing People, Processes And Technology

From a legal perspective, clarifying the legal status of, scope of responsibility and past practices of employees, agents and contractors of a target entity is an important

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part of a due diligence effort designed to uncover risks associated with bribery and corruption. In many cases, companies may have robust business processes, including many that feature enabling technology, which discourage questionable business practices. Target companies may have a strikingly different approach to managing questionable business practices, and understanding such controls at a targeted company will be a very important clue as to what kinds of risks may be associated with the proposed transaction.

Committing The Necessary Time

As transactions become larger, more complex and more global in nature, the time spent on deal due diligence and the scope of factors to be considered by the deal team is constantly expanding. For example, there are significant financial and/or legal penalties associated with business conduct on the part of an employee, an agent or a contractor of a targeted company that stray into any of the following broad areas of questionable conduct that can scuttle approval of a deal by the board or regulators:

- antidumping allegations
- antitrust, including price-fixing and bid-rigging

- bank fraud
- bribery, gratuities and public corruption
- commodities futures trading fraud
- computer fraud
- currency violations
- customs import and export violations
- environmental crimes
- extortion
- false statements and perjury
- immigration-related crimes
- insurance-related crimes
- mail fraud
- money laundering
- passport and visa fraud
- procurement fraud
- securities fraud
- tax fraud
- trade secrets theft
- wire fraud

In addition, depending on the primary and secondary jurisdictions in question, there may be specific laws, such as the Foreign Corrupt Practices Act (FCPA) and others, and detailed compliance requirements implicit in such laws, that must be considered.

As the securities environment becomes more challenging – increased enforcement, potentially crippling sanctions and penalties, more private class actions and higher settlement costs – the deal team must have a deep understanding of the financial and disclosure regulatory landscape as well.

Each of these factors may play into a decline regarding pricing, allocation of risks within the purchase agreement, operational needs post-closing and push a decision as to whether to proceed with the transaction at all.

The Finance And Accounting Perspective

Finance and accounting professionals are very involved in the financial due diligence of any deal, but the emergence in recent years of bribery, corruption and other compliance-related risks has increase the importance of considering finance and accounting control risks as well. While compliance risks have been perceived historically as less relevant in the context of the overall deal terms, they can have a significant impact on its post-close economics and value.

Identifying and understanding the fraud, corruption and financial controls risks associated with a deal can be a powerful tool in evaluating the overall risk of a deal. Identifying these risks during the due diligence process allows for more informed negotia-

tions, closings and integrations. While agreeing that the importance of understanding and identifying fraud-related compliance may be easy, often the difficult task is implementing a reasonable and effective approach. Companies are trying to increase the effectiveness and efficiency of their acquisition teams, and at times that can be at odds with adding new areas such as FCPA due diligence. A few ways to focus on raising the effectiveness of accounting-related fraud due diligence and maintaining efficiency are as follows:

- Integrate due diligence teams
- Use risk assessments
- Be flexible
- Follow through post close on issues identified

The goals for each of these areas are to increase efficiency and use available resources to identify the critical issues that may materially impact either the deal itself or its post-close success.

Integrated Due Diligence Teams

Integrating the due diligence team with compliance or investigative resources increases the likelihood potential fraud issues will be detected. Depending on the details of a transaction, the involvement may vary from simply being involved in the planning and brainstorming surrounding the due diligence process to the point of deploying forensic accountants in the field. The goal of integration is to involve the compliance professionals earlier in the process. Too often, the compliance team is brought in on an issue late in the process and the result is either a late, ineffective or inefficient process. For example, having the FCPA and other corruption risks appropriately considered at the beginning of an acquisition can result in more effective data and document requests. It may also impact the decision of what on-site due diligence visits to make.

Risk Assessments

While assessing the fraud and corruption risks may seem simple, it is more of an art than a science. There are certainly general guides to follow, for example asking and answering the following types of questions:

- Has the target had any fraud issues in the past? How were they resolved?
- What countries does the company sell into?
- What are the company's bribery and corruption policies? Training?
- How are fraud risks monitored? Who does the monitoring? What documen-

tation exists?

- Does the target perform due diligence on third parties? Do they track and understand how many and what third parties they do business with?
- Does the target have government or state-owned customers?

These are just a few of the questions that could be considered in devising or integrating fraud concerns into a due diligence plan. No matter what the type of acquisition there will be a limitation on the resources that may be utilized to identify fraud issues. A proper risk assessment will take these limitations into consideration and aim for getting the most out of the time and resources available.

Flexibility

Focusing on flexibility acknowledges the limitations on time and resources as referenced above but it also acknowledges the draw-backs of pre-determined checklists and approaches. While there certainly may be due diligence steps that will be followed in any transaction, flexibility to react and change course is important.

For example, a common scenario faced by an acquirer is that potential bribery payments by the target are raised as red flags in a particular country. In this type of situation, on-site due diligence may be the next step and it is often the case that very little is known about the operations at the location in question. It is important in this situation to get away from a "check list" approach and fully assess the objectives and implications of further due diligence.

Post-Close

Following up on potential fraud or corruption issues that were identified throughout the transaction is a key point of any post close checklist from a legal, financial and accounting perspective. While the issues identified may not have risen to the level of affecting the transaction, they may still have a material impact post-close if not resolved. It may be that, unchecked, the potential issue is considered to be tacitly approved by the new management team. Or it may worsen and create more risks and liabilities at a later date. For example, a failure to remediate problems identified in diligence after closing may be seen as evidence of a willful violation, potentially resulting in enhanced liability. These are the results that can come back and potentially impact the valuation of a deal. At a minimum, red-flags identified during due diligence need to be remediated going forward.

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