Hogan Lovells

Steering the Course

Navigating bribery and corruption risk in M&A

A global study by Hogan Lovells

Contents

Too few companies do enough to counter bribery and corruption in M&A and private equity investments. Instead, they busy themselves with due diligence on tax, antitrust, legal, financial, intellectual property, and other asset or industry-specific areas. None of which makes a difference if the company you're after is corrupt.

That's why anti-bribery and corruption due diligence matters, and sooner rather than later. However, the level of due diligence needed will vary depending on the perceived risks.

Compared with 10 years ago, when the U.S. Department of Justice (DOJ) was the only real anti-bribery enforcer, today regulatory focus has stepped up. Authorities in China, Brazil, Germany, Italy, Spain and the UK, among others, all enforce their anti-bribery legislation. Other countries continue to jump on the bandwagon at a rapid rate.

There's also far more awareness of these types of issues. The press is well briefed; it encourages whistleblowers to divulge information, and journalists are investigating. Regulators are talking to each other and sharing information, too.

In short, you're much more likely to get caught. And if you do, as a company you get criminally prosecuted for bribery, and you risk fines, while your executives risk jail sentences.

Even so, our study of in-house legal and compliance teams shows that in many companies these risks aren't taken seriously.

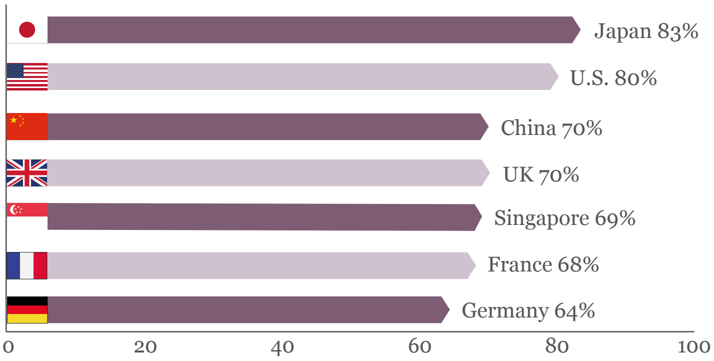
We interviewed 600-plus chief compliance officers, heads of legal, or their equivalents at multinational companies turning over at least US$350 million. We've combined the responses with insights from lawyers in our global Investigations, White Collar, and Fraud practice. This report, the third in our *Steering the Course* series, explores bribery and corruption trends that compliance teams face in M&A.

Crispin Rapinet
Global Head of Investigations, White Collar, and Fraud

Let the compliance team lead the way

One overriding message is that management doesn't bring in the compliance team in good time:

72% of respondents say their compliance team should be involved earlier in M&A discussions.



This is a missed opportunity; ideally, compliance should be first in and last out. Tax and antitrust due diligence have their place, of course, but anti-bribery and corruption really is an equal priority.

When involved early, the team can help shape management's conversations with the target company. It can also assess potential bribery risks, to work out the type of due diligence needed – simple or something more sophisticated. This enables you to devise a risk-based, or proportionate, due diligence process customized to your business, industry, and the bribery risk of the company in your sights.

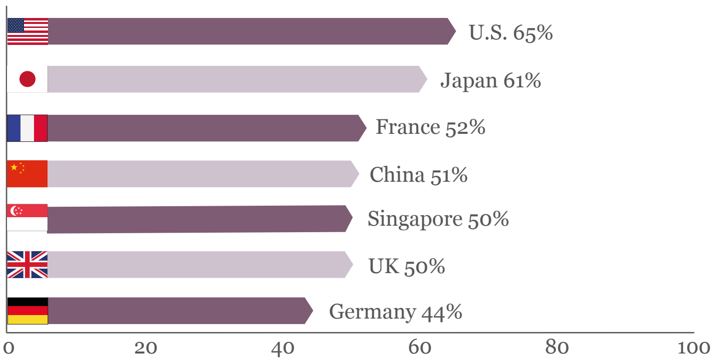
Investing in or buying a company linked to bribery isn't always a deal-breaker since it's often better all round if as the buyer you then clean up the business. The bigger problem is not knowing the bribery risk until late in the day.

If your due diligence finds a problem early on, it puts you in a good position to negotiate on price before you buy. You can use it to get the company to sort out the problem. You can walk away empty handed, with your reputation intact. Or there's the possibility to agree with the authorities a grace period after the acquisition when you disclose and mitigate any bribery. Either way, as there may be unseen trip wires such as money laundering issues, you need advice before you raise any red flags.

You also have the option to ask the DOJ for an opinion release, a non-binding guide to whether it would treat certain conduct as likely to raise U.S. Foreign Corrupt Practices Act (FCPA) liability. If cleared, you can presume that, based on enforcement policy at the time, the DOJ doesn't consider the conduct you described a liability. But opinion releases are double-edged. Asking for an opinion attracts the attention of the Fraud Section of the Criminal Division, which could later investigate FCPA violations.

On the other hand, if you don't do the due diligence or don't do it thoroughly enough, then you risk not spotting a compliance problem until it's too late.

More than half (54%) of respondents say their pre- and post-M&A due diligence isn't thorough enough.



Due diligence in private equity

As well as doing anti-bribery and corruption diligence on a target company, private equity houses (general partners) themselves are on the receiving end. Prospective investors (or limited partners) scrutinize the general partner's compliance history and protocols, and if they think it doesn't take the right approach, they won't commit capital. So there's an incentive for the general partners to show they have in place an acceptable approach when assessing the target company.

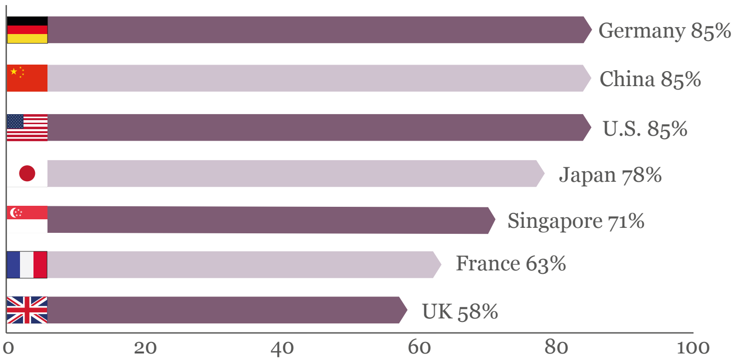
"Private equity houses should also make sure that any covenants that they obtain from management teams in portfolio company documentation comply with their own compliance processes."

Ed Harris, Private Equity UK Lead

Even in a friendly deal, a target company may not wish to share sensitive information with you. As a public company, it may be restricted in what it can provide. In a hostile bid, speed may preclude full due diligence. Or in an auction, tensions could limit the information you're given, your access to employees, or both. This doesn't mean you can do away with due diligence, but that it's all the more important to do it afterwards.

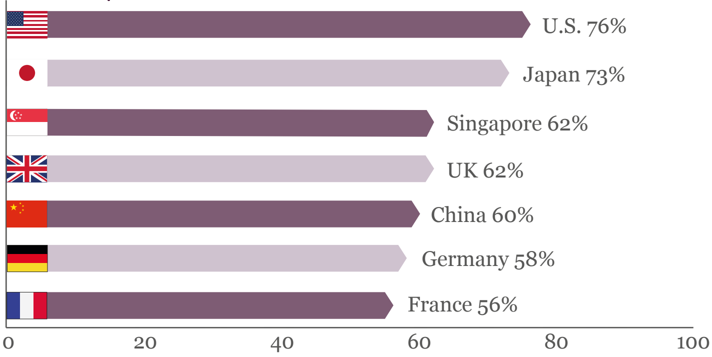
There are, it seems, many who remain to be convinced.

Only 58% of respondents from the UK do anti-bribery and corruption due diligence before high-risk M&A.



In other words, astonishingly, just under half do not do any due diligence in this area. In contrast, China, Germany, and the U.S. lead the way at 85%.

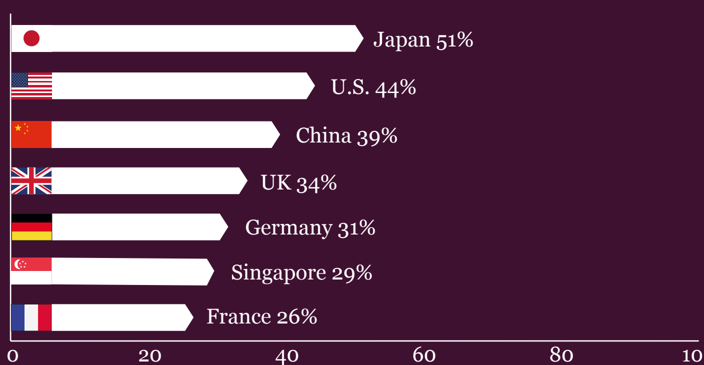
Meanwhile 64% of respondents said M&A gives rise to some of the biggest anti-bribery and corruption risks (76% in the U.S. compared with 56% in France).



One of the big concerns for M&A is successor liability. In M&A you may inherit your target company's liability for any earlier corrupt acts, even if you knew nothing about them. And you remain liable if you fail to tackle bribery risks that come to light after a deal closes, as well as for buying or investing in a company you knew to be corrupt.

> "Some companies stagger their due diligence – front-load one or two specialist areas and defer anti-bribery and corruption. If they then find a compliance concern while the rest of the deal is moving apace, they run a risk of not having time to resolve it."
>
> *Bill Curtin,*
> *Global Head of Mergers and Acquisitions*

36% overall see M&A as one of the biggest external risks to their company (51% in Japan compared with 26% in France).



Prosecutors making the case for due diligence

> “With more and more local prosecutors picking up the baton in their part of the global marketplace, there are few countries left where companies can hope to remain unchallenged.”
>
> *Crispin Rapinet, Global Head of Investigations, White Collar, and Fraud*

Both the FCPA and the UK Bribery Act potentially have jurisdiction over companies operating overseas. The scope of the FCPA, in particular, and the grounds under which the U.S. authorities can extend their reach leave nowhere to hide where you can do business risk free from a U.S. prosecutor. Due diligence is a first step toward mitigating corruption and steering clear of liability.

Proper risk-based due diligence will make you a less attractive target in the eyes of a prosecutor – there is plenty of low hanging fruit for them to pick. The best approach is that you can show you acted responsibly by undertaking risk-based due diligence as far as possible ahead of the deal and then a deeper dive after acquisition. This supports the fact that you have a proper or “adequate” anti-bribery and corruption compliance program in place, which at the end of the day may be your only defense.

Signs of ethical leadership

Due diligence helps you understand the target company's culture, assess its value – whether it results from bribery – and identify risks and related problems. Take contracts "won" through bribes, for example. They're likely unenforceable in law, and they may depend on continued bribes. Also, earlier corrupt acts, if not redressed, may affect your reputation, future business, or both.

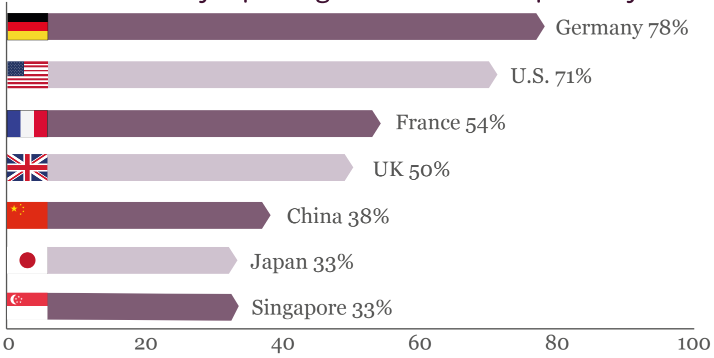
"Compliance issues are people issues. They can't be addressed by price or contract language alone. And they can move a transaction not just from a green light to a yellow light – but to a red, and in an instant."

Bill Curtin,
Global Head of Mergers and Acquisitions

It's a common-sense approach that should start with the tone from the top (see our first report, *Steering the Course: Navigating bribery and corruption risk*, at www.hoganlovellsabc.com). Do the CEO and board at the company you want to buy consider anti-bribery and corruption a priority? Or are profits and returns higher on their agenda? After all, if the leadership turns a blind eye to compliance issues, there's little reason for the company not to follow.

And beyond the leadership team, you should speak to people at all levels in the target company, to gauge how far the compliance message filters down. Proof of good practice shows the quality of management.

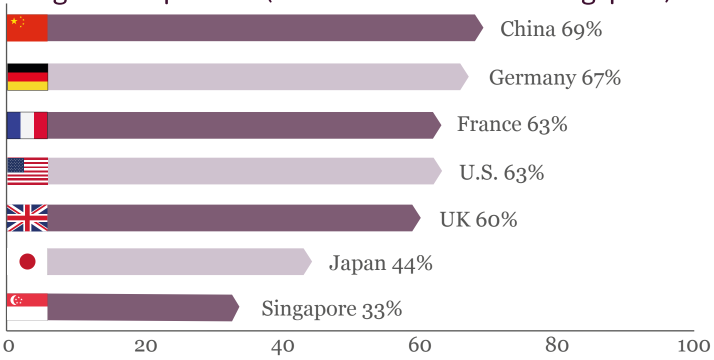
57% of respondents have gone ahead with a merger or acquisition despite high bribery and corruption risk, with the U.S. and Germany reporting 71% and 78% respectively.



This suggests that companies continue to underestimate what they're exposing themselves to. Goodyear Tire & Rubber Company, for example, missed improper payments its newly acquired subsidiaries made. It did neither adequate due diligence before close nor adequate compliance training after, according to the U.S. Securities and Exchange Commission. In 2015, Goodyear paid US$16 million to settle.

Our study also revealed:

59% say that sometimes their anti-bribery and corruption due diligence doesn't take place until after a merger or acquisition (69% in China vs 33% in Singapore).



At which point there's no window to negotiate on price.

Post-acquisition due diligence

Because pre-close disclosure can often be incomplete, only after signing will you really know what you've bought. You can limit your liability even at this stage through post-close due diligence, or an audit. You must consider reporting any suspected bribery you discover to the authorities. Speed, openness, and self-disclosure make all the difference to how they react.

"The first 100 days after close are crunch time. It's when you really get to see what you've bought – warts and all. For a start, you should review the accuracy of financial records and internal controls."

Isabel Carvalho, Partner, São Paulo

10 days

As a guide, within the first 10 days, you need to examine any issues you identified but left unresolved during earlier due diligence. You need to review the company's risk assessment of its own bribery risk and the measures it has in place to counter this. You may need to upgrade these if they fall short.

100 days

Before 100 days in, you need to review all third parties or at least the high-risk ones, because you have little control over them (see our previous report, *Steering the Course: Navigating third party bribery and corruption risk*, at www.hoganlovellsabc.com). You need to reassess the tone from the top, and particularly the company's training program for anti-bribery and corruption. You should assess whistleblowing procedures and historic whistleblowing reports. Because if there are no reports, it suggests the procedure isn't working.

1 year

And within one year, you need to decide whether to merge your two compliance programs or adopt one over the other. Ideally, you need to bring the new company into line with your code of conduct and anti-bribery program, including training and monitoring. Although this can take up to two years, it ranks alongside commercial integration in terms of priority.

> "If it's a sales-driven company, you should look at how sales targets are set and how this fits in with bonuses. How is the sales team incentivized?"
>
> *Stephanie Yonekura, partner, Los Angeles*

For practical next steps on how to assess your anti-bribery and corruption program, visit www.hoganlovellsabc.com. Our benchmarking model is a good place to start. You can email us at abc@hoganlovells.com. Or you can get in touch with one of our lawyers. They know first-hand how to get under the skin of a target company anywhere in the world.

Research methodology

The study is based on independent opinion research designed and commissioned by Hogan Lovells in January 2016.

The research was conducted amongst 604 chief compliance officers, heads of legal or equivalent at 604 of the world's largest multinational companies.

Respondents were all from companies with a minimum of 2,000 employees and at least US$350 million turnover, and had been with the company in that role for more than a year.

101 respondents were from the UK, 102 from Germany, 100 from France, 151 from the U.S. and 150 from Asia. Within Asia, 57 were from China, 52 from Singapore and 41 from Japan.

Focusing on high-risk sectors at the heart of global anti-bribery and corruption regulation and investigations, 124 respondents were in life sciences, 138 in energy, minerals and resources, 152 in transport, and 190 in technology, media and telecoms. The research was conducted by Coleman Parkes.

You can find our compliance guide, mini-assessment quiz and full report on hoganlovellsabc.com

Our team

The Hogan Lovells Global Bribery and Corruption Task Force offers international clients informed advice in a number of areas of risk, from reactive incident response measures to the development of proactive strategies for managing potential exposure through compliance programs.

Our task force brings together a cross-jurisdictional team of partners from Hogan Lovells' international network with more than 25 years of experience in large-scale investigations. The task force has real experience on the ground in the U.S. and Europe (including the UK, Germany, Spain, Italy, and France), as well as in Russia, Asia (including China, Hong Kong, Singapore, and Jakarta), Latin America, and Africa. Hogan Lovells is a recognized leader in investigations and fraud work, being ranked in the top tier of leading legal directories.

> "Hogan Lovells is among an exclusive group of firms that field top-level investigations specialists right across the globe. This is reflected in the quantity, quality and breadth of matters it handles. The firm has a truly impressive number of senior investigations lawyers within its ranks."
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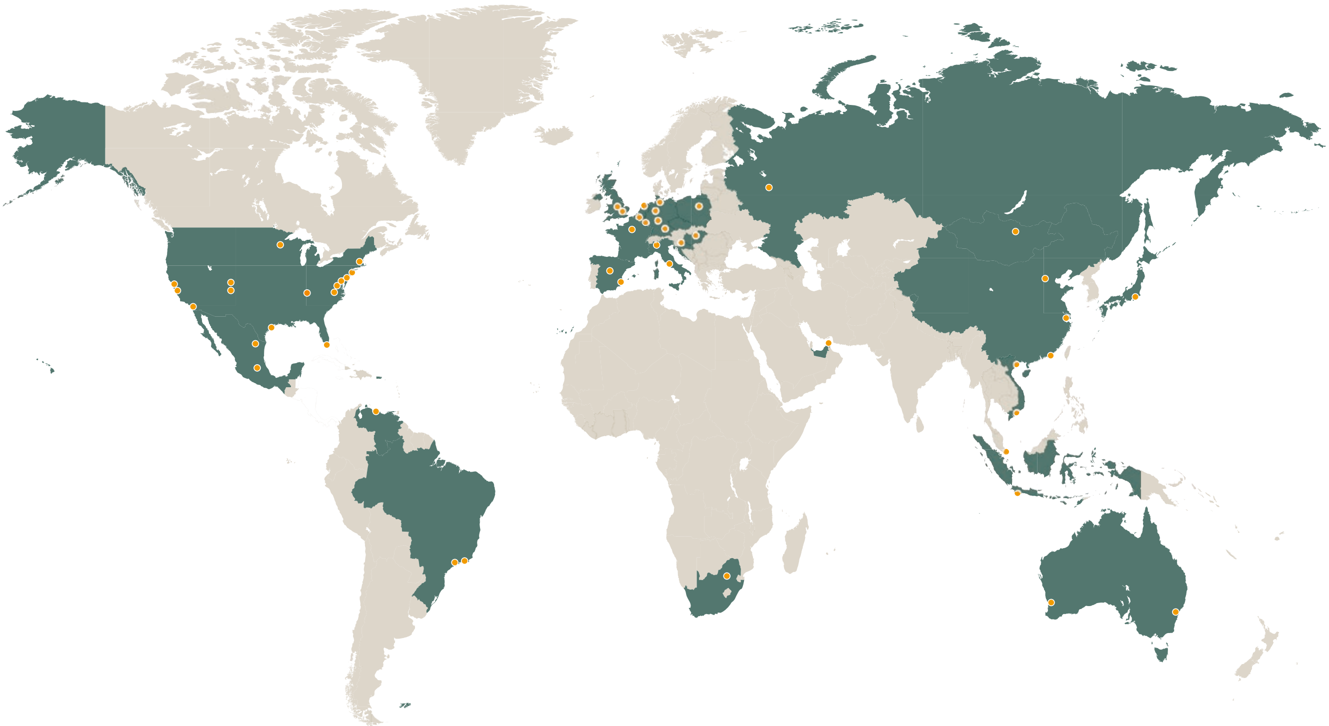
> *Global Investigations Review (GIR) 30, 2016*

Contact us

To discuss any of the issues raised in this report, please contact one of the team:



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Our team has a wide range of backgrounds. Diversity of backgrounds and experience delivers a broader perspective. Perspectives which ultimately make for more rounded thinking and better answers for you.

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