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MERGERS & ACQUISITIONS

FCPA Evolution Through an M&A Lens: The Compliance Value-Add

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Revisiting the evolution of modern FCPA enforcement through the lens of mergers, acquisitions and divestments (M&A) illustrates just how influential M&A was in shaping both anti-corruption enforcement and compliance practice. M&A touchpoints have played a critical role in the development of FCPA enforcement, guidance and the ever-increasing professionalization of corporate compliance practice.

As discussed in the first installment of this two-part article series, the common thread is that "you are what you buy." Responding to the risks of FCPA-related successor liability and potential rewards presented by successful compliance integration has, and will, continue to impact M&A strategy across industries and investor groups.

This second installment of our two-part article series focuses on how the history of FCPA enforcement and M&A have created a current opportunity for compliance and provide six practical strategies for moving compliance from a company cost-center in M&A transactions to a value driver. In brief, those strategies are to:

- remember that timing is everything and that early involvement drives value;
- step into new high-value roles;
- understand risk drivers and business objectives;
- be mindful of the unique risk profiles of minority investments;
- coordinate due diligence across borders, just as enforcement does; and
- learn to leverage resources to identify and mitigate emerging risks.

See the Anti-Corruption Report's three-part series on managing M&A anti-corruption risk: "Pre-Deal Prep" (Oct. 3, 2018); "Pre-Closing Risk Assessments and Due Diligence" (Oct. 17, 2018); and "Deal Terms and Integration" (Oct. 31, 2018).

The Value Proposition

U.S. enforcement guidance has long made clear its baseline expectation as to risk-based and fit-for-purpose M&A due diligence consistent with the relative size, resources and risk profile of a transaction. Recent guidance updates and enforcement actions have gone on to emphasize post-close compliance integration planning and execution as both a potential practical enabler in getting to the point of close, and, if forgone, a clear risk to the buyer/investor in future enforcement decisions should the company later find itself before U.S. authorities. In addition, conversations as to the value proposition of M&A and FCPA due

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diligence and compliance integration have significantly shifted over the last ten years. This shift is in large part due to the impact of reputational risk and stakeholder influence, resulting in a growing recognition of the commercial value in, and case for, corporate responsibility – including compliance due diligence.

The risks and values combine to make the bottom-line impacts of non-financial risk clear. This influence is being felt on all sides of, and types of, transactions. Increasingly knowledgeable investors, including a new generation of private equity and venture capital firms, are creating a pull for non-financial due diligence. Certain constituencies are even seeing the longer-term value proposition of compliance institution building, influencing or even compliance turnaround, within portfolio companies. Corporate leadership are increasingly recognizing the potential for strong compliance programs as an element of successful IPO, or a business enabler with key stakeholders. This rise in stakeholder expectations has given birth to a cottage industry of FCPA M&A due diligence in compliance consulting and law firms alike. With the COVID-19 pandemic creating even more emphasis on every element of ESG, corporate responsibility and the "how" of how companies operate and interact with stakeholders, the bottom-line value of non-financial risk due diligence is only likely to grow.

Corporate compliance functions, and those that advise them, can seize this opportunity to cultivate and highlight the value proposition further, via practical approaches that can also simplify, save time and decrease related points of frustration. They can cultivate this value, via the six practical strategies outlined below.

Opportunities: Mitigate Risk, Create value and simplify execution

1) Timing Is Everything – Early Involvement Drives Value

Changing the timing of compliance engagement and role in the transaction can increase value. As we discussed in a previous article, there are three key roles of compliance: guide, problem-solver and gatekeeper. The earlier compliance personnel are engaged in the process, the more likely they can bring the additional value of the guide role.

In traditional anti-corruption due diligence, in-house compliance or external counsel are typically consulted after a specific transaction is identified and, perhaps, even after business decisions on material terms and structure have been negotiated and a deal deck is circulated. By this time, compliance counsel, at best, can act as problem solvers but, even more likely, they are already in the de facto position of gatekeeper, with the associated adversarial posture and limited advice options.

Actively engaging compliance as a guide at the strategy phase allows the business to factor non-financial risk into their early business decisions. Early business growth strategies will naturally consider the financial and related reporting as to the market, industry or jurisdiction for potential growth. With the real bottom-line impacts of non-financial risk, it makes just as much sense to now also include non-financial risks. This allows the business to factor in, for example, how a target's growth strategies will impact upon its own risk profile and related compliance resourcing. In this

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context, an acquisition in a high government touchpoint industry, in a higher corruption risk jurisdiction and with a business model that relies heavily on third-party distributors, may not only have a higher risk of historic improper payments but, going forward, mitigation may require more significant investment in compliance integration, in-country personnel or processes (*i.e.*, increasing time and spend). There is a business advantage to being able to factor these potential costs into early calculations in order to better compare options and growth paths. Here, compliance can function as valuable guides and provide information for more informed business decision-making.

See "Effective Compliance in the Spotlight: Roles, Reality and Real-Life Suggestions" (Nov. 13, 2019).

2) Step Into New High-Value Roles

Focusing on areas outside of traditional pre-close due diligence, such as strategic counseling, threshold risk profiles and post-close compliance plans, with simple principle-based tools, can create a business "pull" toward compliance.

Strategic Counseling

Compliance counsel can provide examples and valuable early information, earning a seat at the table with business strategy teams, bringing awareness of what compliance has to offer. This presents the opportunity to step into a strategic counselling role. As specific transactions and proposals are outlined, strategic counseling can also involve early and effective issue spotting and defining the fit-for-purpose diligence scope which can impact timing and transactional costs of different options. Having that early mandate and plan can also streamline the process from due diligence through post-close integration.

Threshold Analysis

Threshold analysis is another key early role and value-add. Getting compliance involved early to provide the business a general threshold risk profile based on key corruption risk drivers, such as jurisdiction, industry, government touchpoints and business model (including especially the level of reliance on third-parties), can not only mitigate risk and protect an investor, but can also create value in the decision-making process. Creating a threshold risk profile early on will enable timely identification of key counseling and decision points regarding assessment of potential successor liability risks and going forward risk of future misconduct, post-close. Adding a threshold analysis option can also:

- enable acquirers to realize the benefits of factoring in potential compliance-related costs against projected profits at an early stage;
- allows compliance counsel the opportunity to provide significant input into business planning discussions; and
- promotes alignment with the acquirer's broader strategic business growth plans.

Offering threshold risk analysis to your business early on, even where this is just based on publicly available information, will also help to shift the timing of compliance engagement and increase its value.

Post-Close Planning

Compliance can also step in and illustrate how post-close compliance plans can function as an enabling opportunity; especially in auction or other transaction settings where pre-close due diligence is functionally or legally limited.

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In this context, the Halliburton Protocol, which we describe more fully in the first part of this series, is a unique recognition by enforcement authorities of pre-close realties where the full scope of compliance assurances are not available in time. Deployed properly, the Halliburton Protocol can provide an effective response and mitigation when pre-close information is scarce. Shifting the focus to one of enabling opportunities is a strategy that can bring compliance and business teams into alignment.

Key to this approach is creating a documented post-close compliance plan, including factoring in the costs of risk mitigation into the business or board decision-making pre-close. Beyond consistency with updated DOJ Guidance, an endorsed and resourced plan ensures post-close compliance is a credible enabler to close, rather than an excuse to get there.

User-Friendly Tools

Convincing the business to bring compliance in earlier in the M&A timeline can be encouraged with user-friendly tools. Keep strategic counseling and threshold analysis based on a simple, straightforward and principled set of factors.

It is important to remember, this is just at the threshold, it is not the full due diligence exercise … yet. However, it is a great chance to repeat those straightforward risk drivers covered in annual anti-corruption training, while talking in the terms of the business transaction. Make these approaches principled and repeatable. It might be surprising how fast the business starts to bring ideas to compliance already in the threshold analysis form or business stakeholders start to repeat and apply the factors before compliance comments. Make a commercial case with a logical user-friendly process, and the conditions will be right for the business to pull compliance into early M&A strategy.

See "Structuring M&A Transactions to Minimize Corruption Risk" (Oct. 18, 2017).

3) Understand Risk Drivers and Business Objectives

Corruption risk lies in the business, and where and how it operates. Unlike some other topics, a target will not provide a complete file containing their "corruption" risk related materials. Rather, corruption related due diligence should always be a multi-faceted inquiry, targeting key areas where evidence of potential risks and improper payments may be found including, for example:

- company financial information such as sales jurisdictions, customers, accounts and expense categories;
- industry and operating model;
- government touchpoints including via supply chain, operations, partners and customer base; and
- business model and growth strategies including use of third-parties and new country or market entries through joint ventures or local partners.

Without due diligence, future investigation costs and/or financial penalties associated with successor liability or continuation of improper conduct post-close, may outbalance anticipated revenue.

There is also a much broader commercial case for due diligence to be made in the range of potential related collateral consequences that can undermine the purpose of a transaction in

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many different ways. This is why it is important to understand and focus on the investor or buyers business objectives – how is the target or asset going to fit in the investor/buyer's business strategy and compliance program? For example, a target might be making facilitation payments that they contend are not illegal under applicable regimes and cannot deliver a key element of their product without the payments but the investor's/buyer's compliance program prohibits such payments outright. Compliance teams can bring value here by helping the business to take a broader view of the risk profile of a proposed transaction, including by identifying factors that may impact strategic transaction risk and value calculations. Therefore, due diligence can put resources to risk by focusing on both the target's business practices and how they interact with the investor's/buyer's strategic objectives.

See "How to Use Data Analytics to Mitigate Risk When Conducting Post-Acquisition Diligence and Integration Activities" (Oct. 4, 2017).

4) Be Mindful of the Unique Risk Profiles of Minority Investments

It is how an investor is going to act, not just how much an investor owns that can create risk in minority investments. Therefore, compliance should always focus on the why and the how of business proposed minority investments.

While holding a minority stake, an investor may undertake activity via employees, board members, agents or advisors to assist the portfolio investment in strategy and building value including taking the investment to the next level of IPO, sale or integration. These activities of agents of the investor can create anti-corruption touchpoints.

Recent U.S. enforcement has shown the importance of conducting pre-acquisition FCPA due diligence and instituting, where necessary, post-close review and integration efforts, including in the April 2020 FCPA settlement between the SEC and Italian multinational oil and gas company, Eni S.p.A. in relation to a minority investment in Algeria. By thinking proactively about minority investments at each stage, investors can mitigate these risks, as well as ensuring the ability to appropriately influence and monitor the investment's compliance representations and program going forward. This also means building in consequences including, ultimately, the ability to exit the investment.

Compliance should also beware of incremental investments that can take a company the way of the "boiled frog." Even relatively small initial passive minority investments can become active growth investments over time, bringing an increase in operational touchpoints and FCPA related risks. Incremental investment strategies in particular can pose the risk of missing a thorough review of related risks. Here, although the buyer may have a history with the target company, and think it knows about the overall company and strategy, conducting appropriate due diligence and risk assessment at each phase increases informed decision-making, supports value creation and avoids investors becoming lulled into comfort – like "boiled frogs" as the risk slowly increases like the water temperature in the pot. In these cases, if compliance is engaged early, they can explore with the business the ultimate growth strategy and right-size the due diligence on the front end. Alternately, compliance can recommend triggers for risk review at each stage to promote informed business decision-making and allow for implementation of mitigating controls.

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See our three-part series on managing corruption risk in portfolio companies: "Understanding Liability" (Apr. 3, 2019); "Assessment, Diligence and Walking Away" (Apr. 17, 2019); "Monitoring and Oversight" (May 1, 2019).

5) Coordinate Due Diligence Across Borders, Just as Enforcement Does

Anti-corruption enforcement encompasses more than the FCPA today. Identifying the baseline anti-corruption profile and appropriately scoping the additional jurisdictional specific risks and regulatory requirements is critical. Due diligence scoping should consider both the investor's and the target's jurisdictions, industries and business models, including how they go to market, as well as deal structure and nature of investor involvement, to determine the appropriate jurisdictional scope of review for anti-corruption risks. The ever-increasing promulgation of local anti-corruption laws, such as the U.K. Bribery Act of 2010, France's Sapin II, and new and enhanced anticorruption enforcement regimes introduced in countries including Brazil, Mexico and India, among others, may all impact upon a proposed transaction.

Compliance advisers should also be increasingly alert to the differences emerging between the various local anti-corruption requirements that may be applicable to the target and investor, as well as their suppliers, customers and third parties. Factoring in the need for multi-jurisdiction corruption compliance analysis and local law considerations at the initial mandate and scoping phase of a transaction will help to avoid any unnecessary delay or surprises.

See "Patricia Etzold of PwC Discusses Effective M&A Due Diligence That Won't Hamper Future Relationships" (Apr. 12, 2017).

6) Learn to Leverage Resources to Identify and Mitigate Emerging Risks

In a trend that shows no signs of abating, many in-house compliance programs are increasingly being asked to address a broader scope of risk subjects with the same or fewer resources. At the same time, stakeholder and investor awareness continues to grow around a broader spectrum of non-financial regulatory and compliance risks. As M&A company valuation considerations need to adapt, it is clear that thinking about multi-disciplinary non-financial risk areas proactively can help protect and grow both reputational brand and bottom-line value.

Conveniently, many non-financial risk areas of due diligence require the same information and have similar risk drivers, creating opportunities to both coordinate and simplify. Essentially, compliance has the opportunity to cover more risk, with the same resources.

For example, in-house teams can look to leverage core topics like corruption, trade sanctions, competition, AML, cyber/privacy, employee relations/labor and health and safety, alongside a variety of other non-financial risks, including other ESG risk such as inclusion and diversity, whistle-blower protection, supply chain sustainability/local content, modern slavery/human rights/forced labor, environmental/community impact and climate change/fossil fuels.

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Easy lift in-house compliance projects can have a big impact, including steps as simple as:

- distilling each subject area's diligence requests, documents and advice into a non-financial risks summary section within the M&A team's existing spreadsheets or other templates to streamline the spectrum of non-financial risk considerations;
- compiling a pre-identified key contact list in each area, a deceptively easy, but impactful tool; and
- identifying emerging subject areas that may be missing from existing templates and making updates.

Finally, one way to introduce one or multiple of these new M&A due diligence approaches, is to find a small pilot project that provides the opportunity to demonstrate the benefits of simplification in a real transaction context. It provides a way to highlight the benefits and value compliance is creating and also allows for real-time business feedback to further improve ways of working. Nothing succeeds like success – both compliance and the business, may be surprised at how quickly the elements that work well become the new status quo going forward.

As businesses begin to adjust to their new post-COVID-19 business models and ways of working, we can expect to see companies and investors look to new growth opportunities. With greater scopes of risk and greater potential rewards coming into view, in-house compliance counsel who demonstrate confidence and proactive leadership in tacking the M&A due diligence and post-close integration challenge have the opportunity to not only protect value, but also enable sustainable growth for the businesses. The potential for compliance to go beyond a risk mitigation M&A cost-center, to a value-center for company growth strategies, has never been clearer.

See "Five Steps to Establishing a Corporate ESG Policy for the Present Moment" (Oct. 28, 2020).

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