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Make Sure Your M&A Due Diligence Checklist is Complete

Compliance and Ethics



The June *Docket* article, "The Missing Topic on Your M&A Due Diligence Checklist: Successor Liability for Export/Import and Sanctions Violations" presents the following scenario:

Your company is in the midst of an acquisition. During negotiations, a standard due diligence process is followed, including reviews of financial statements, contracts, accounting policies, corporate documents, employee benefits and insurance. The deal ultimately goes through. Months later in the post-acquisition transition it is discovered that the acquired company violated both US and foreign trade laws. It may have happened years ago, but your acquiring company can still be held liable.

This isn't beyond the imagination of most in-house counsel, as recent headlines can attest.

- Goodyear's recently settled \$16.2 million with the US Securities and Exchange Commission (SEC) over liability it inherited as a result of two African subsidiaries' past misconduct.
- In 2014, the government of China handed UK drug maker GlaxoSmithKline a fine of nearly \$500 million (the highest corruption-related fine ever imposed on a private company) because its local subsidiary was found guilty of bribing Chinese doctors.
- In 2009 Qioptiq S.a.r.l (Qioptiq), a Luxembourg-based company, agreed to pay a fine of \$25 million to the Directorate of Defense Trade Controls (DDTC) at the Department of State. The fines were primarily based on past ITAR violations of a company it acquired and concerned unlicensed exports of night vision items.

According to the article: The best way to avoid the unpleasant surprise of an inherited liability before an international merger or acquisition is to conduct due diligence on export compliance with various government agencies that oversee trade and with those of other governments where the target company does business.

"A Lean Approach to Evaluating and Addressing Export Compliance Issues in M&A Transactions" offers this practice tip:

Identify and schedule notifications that need to be filed with the relevant agencies early in the process. Note, for instance, that in cases involving acquisitions by, or mergers with, a foreign person, DDTC requires notification 60 days prior to closing. License amendments should be promptly filed as licenses may not be used until the amendment is approved by DDTC.

The following is a list of import and export topics to include your pre-acquisition checklist. This list is not exhaustive but can serve as a guideline. A more comprehensive list should be developed for an audit.

- 1. Export compliance, including an assessment of State and Commerce Department product classifications; risks based on end-use, end-user and export destinations; registration requirements; and export licenses.**
- 2. Import compliance, including proper markings, tariff classifications, required accompanying documentation and compliance with applicable quality standards, and import licenses.**
- 3. Antidumping and countervailing duty assessments, including inquiries into whether unknown or ongoing unpaid duties exist as a result of transactions with certain foreign manufacturers.**
- 4. Re-export risks of product diversion contrary to US and applicable foreign law.**
- 5. Deemed export issues concerning the release of controlled goods and technology to foreign nationals inside the United States, or deemed re-export issues concerning activities outside the United States.**
- 6. Cloud computing and other network issues creating unintended or unanticipated exports requiring licensing.**

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7. **FCPA compliance including an assessment of books and records, risks based on location and nature of business, internal control measures, compliance culture, political activities abroad and third-party actions.**
 8. **Anti-boycott reporting requirements and compliance procedures.**
 9. **US and EU sanctions and embargos compliance including an assessment of applicable sanctions programs based on product type, shipment destinations, initial buyers, end-uses, and end-users.**
 10. **Compliance education and training, including manuals and management support of the overall compliance program assessing the likelihood of violations, ability to provide mitigation of government enforcement, and the need for restructuring to provide effective protection against future violations.**
 11. **Due diligence risk assessments and documentation of customers and third-party contractors, vendors, agents, distributors, investors and partners for "know your customer guidelines."**
 12. **Documentation of internal compliance due diligence reviews.**
 13. **Past violations inquiry to assess target's relationship with DDTC, BIS and OFAC (in addition to the DOJ and SEC)**

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