

Managing bribery, corruption and regulatory risk in M&A deals

Mergers and acquisitions and/or joint ventures are integral to many companies' growth strategies - whether to lower manufacturing costs, consolidate supply chains, access growing consumer markets, tap into fresh talent or to acquire new products and technology. Yet, with all of the potential upside of doing deals, there are also risks.

Compliance regulation

The current regulatory environment - particularly the Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, as well as many local anti-bribery and corruption laws - makes it unlawful to pay bribes for the purpose of obtaining or retaining business. There are also strict requirements around accounting policies and practices, requiring companies to make and keep books and records that accurately and fairly reflect their business transactions and to maintain an adequate system of internal accounting controls. The absence of documented compliance programs, contracting with intermediaries and agents, providing corporate hospitality for, or sponsorship of, government officials all carry anti-corruption compliance risks especially where companies are carrying on business in a country or industry which is perceived to have a reputation for corruption.

Why should companies in Asia care about compliance risk?

A corrupt or otherwise non-compliant culture carries the risk of some serious legal consequences and can also undermine the very commercial foundation of a business or irreparably taint its assets. You should not assume you are not affected because you are an Asian company that only does business in Asia. Here's why:

The net is tightening!

- While most countries in Asia do not yet have the same sweeping extra-territorial laws or active enforcement as the US or UK, regulators in Asia Pacific are becoming increasingly active, prompted in part by their US and UK counterparts and in part by a groundswell of popular anti-corruption sentiment.



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- Of the top ten biggest settlements under the FCPA, only two are with US companies. The rest are foreign multinationals, several of whom have no shares or debt registered in the US. The US authorities have pursued foreign companies on the slightest of connections to the US (e.g. an email through a US server or the use of US dollar payments cleared through New York). In fact, every two weeks, a company somewhere in the world gets a case opened against them for international corruption in Asia Pacific excluding domestic matters.*
- The strict liability corporate offence under the UK Bribery Act potentially extends to entities with a demonstrable “business presence” in the UK, regardless of whether they have an actual branch office there.
- An Asian company buying a target tainted by criminal conduct from a UK company might find itself in breach of the UK’s anti-money laundering laws for helping that UK seller effectively realise the proceeds of underlying criminal activity. Several countries in Asia and beyond have similar sweeping laws.

It could cost you money and lost business

- Clean up costs in terms of investigating and remediating the problems can be expensive.
- There may be lost revenue and costs associated with loss of business if the target’s business model is unsustainable.
- You might be excluded from future procurement contracts because you or your group is tainted by criminal conduct of the target.
- International financial institutions and non-governmental organisations are becoming more aggressive in sanctioning suppliers and other vendors if there is a compliance breach in relation to projects that they are funding.
- There may be penalties and costs associated with the threat of litigation or regulatory criminal and/or civil prosecution for past misconduct that you have inherited.
- If not fixed, continuing misconduct will trigger future liabilities.

It could damage your reputation...

Think about potential brand damage and, in the case of a listed acquirer, possible impact on the share price.

Or grow into something even worse...

On discovering corruption in a target’s business, a potential buyer may choose, or even be obliged under whistleblower rules to disclose a compliance issue to a regulator. If the regulator uncovers widespread corrupt conduct in the target, this may not only result in the collapse of the sale, but also significant fines, penalties and remediation costs for the target.

This is why, when doing deals, buyers must understand all of the potential pitfalls to determine their best approach - can the compliance risks be resolved pre-or post-acquisition, or is this a true deal-breaker? How does this impact deal pricing, structure and timing? A proper understanding and evaluation of the risks can even strengthen a buyer’s hand in price negotiations.

Real life case study

We recently advised a prominent private equity fund during its acquisition of a company engaged in the distribution of luxury products throughout Asia, but with British connections.

While conducting routine M&A due diligence, we uncovered damaging information about the target company that cast serious doubt on the future of the deal. The document stated outright that it was company policy to follow local market practice, which meant importing products illegally and under-declaring the value of imported goods.

Normally a very nuanced approach to due diligence is required from the buyer’s team to flush out compliance issues. “It’s rather unusual to find a smoking gun,” says Singapore partner Andrew Martin, who led the Baker & McKenzie team. “But in this case there was a document referring to illegal activities and stating, ‘We conduct our business in accordance with Asian market practice.’”

With the private equity fund still eager to acquire the target company, we mobilised our global network of compliance lawyers to investigate the potential compliance issues and suggest steps to address them. One thing our lawyers know from years of handling these cross-border deals is that when compliance issues arise, they are rarely confined to one country. Clients need to consider whether to review all areas of a target company’s operations to determine the scope of the problem and, if necessary, adopt a multi-jurisdictional approach to any further investigation.

* Data is from Ethixbase, analysis is by Baker & McKenzie. Valid as at June 2013

And it's not just buyers - sellers need to be thinking about this too!

Companies seeking to attract a buyer or new investors, or raise funds publicly, should 'get their house in order' prior to going to market. Investors and strategic buyers from the US and Europe may even pay a premium for targets that have a robust compliance program in place, especially in high-risk jurisdictions and sectors.

Baker & McKenzie's 3-step approach to keep you in good compliance health

There is no doubt that compliance can pose significant risks, particularly when a target is active in perceived high-risk regions or industries.

By bringing the Baker & McKenzie compliance experts into the process early, all risks can be considered and informed decisions can be taken. Through proper risk evaluation, planning and execution a compliance breach can be identified and corrected.

It is through our global network of experienced compliance practitioners that we are uniquely placed to help you navigate the complexity of a plethora of far-reaching local rules that impact your deal and the interplay with overarching extra-territorial legislation such as the FCPA or UK Bribery Act.

“...regardless of the technical legal positions, ignoring corruption or compliance issues is, quite simply, bad for business”

1

Take stock

We will undertake a pre-acquisition compliance due diligence review of your target. This will help you:

- Build a detailed picture of the industry and jurisdiction of the target's operations, assess its corporate culture, and identify any potential liabilities
- Understand all of your options in the local law context
- Ask the right questions and get your ducks in a row

2

Frame compliance solutions over the course of the deal process

We will make sure the purchase agreement specifically addresses any compliance sticking points by:

- Including effective contractual protections
- Incorporating structural protections (e.g. conditions precedent to remedy matters prior to closing or by carving out or delaying the acquisition of risky assets)
- Assessing any reporting obligations and options (e.g. mandatory suspicious transaction reporting or the consideration of voluntary reporting of events which may secure more lenient treatment from prosecutors or regulators)

3

Post-acquisition integration steps

We will help you with post-acquisition integration measures by:

- Formulating strategies to maintain a clean bill of compliance health to take the acquired business forward
- Conducting a thorough compliance audit and anti-corruption check of the acquired business (if pre-acquisition due diligence has not been possible)

“Comprehensive due diligence demonstrates a genuine commitment to uncovering and preventing FCPA violations”

US Department of Justice FCPA Guidance, Nov 2012

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