



STEPTOE OUTSIDE COUNSEL

Diligence for corporate transactions: how to manage identified risks

Due diligence is crucial to identifying and managing the sanctions and export controls compliance risks associated with corporate transactions. When violations or other compliance risks are uncovered during the diligence process, it is necessary to consider whether and how those risks can be mitigated effectively if the transaction proceeds. This article (the second in a two-part series) discusses how to respond to the sanctions and export controls risks that often are identified during diligence in corporate transactions and outlines some risk mitigation steps that companies may take.

Responding to risks

A decision must be made about how to proceed when sanctions or export controls compliance risks are identified during diligence for a corporate transaction. Sometimes it may be necessary to call off the transaction when the identified risks are particularly serious, endemic or cannot be mitigated effectively through other strategies. Far more commonly, however, the transaction can proceed subject to the formulation and adoption of appropriate corrective measures.

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legal liability stemming from a target's past misconduct and direct liability for ongoing violations necessitates a multifaceted approach to risk mitigation that includes consideration of disclosure to enforcement agencies, changes to the target's business activities, contractual protections and integration of the target into the acquirer's compliance framework.

In other strategic transactions offering a lesser degree of control such as joint ventures, the inclusion and

enforcement of robust contractual protections in the governing agreement is the primary risk mitigation tool available.

Risk mitigation strategies

As sanctions and export controls risks are identified during diligence, early consideration should be given to implementing appropriate and effective pre- and post-completion risk mitigation strategies.

While there is no "one size fits all" approach to risk mitigation – much depends on the nature of the target's business activities and the risks that they pose in the context of the particular transaction – some pre-completion steps to consider include:

- Incorporating appropriate representations, warranties and covenants in the transaction agreement as well as remedy provisions such as indemnity and termination rights with respect to any historic breaches;
- Developing a remediation plan to address past violations and compliance weaknesses as well as prevent recurrence and future issues through the implementation of corrective actions. Whenever viable, implementation of the plan should begin pre-completion;
- Winding down business activities that would be unlawful if continued post-completion (e.g., sales to Iran when a non-US business comes under the ownership or control of a US person); and
- Making mandatory or voluntary disclosures of sanctions or export controls violations to pertinent enforcement agencies in the M&A context.

Increasingly, enforcement agencies expect risk mitigation efforts to continue post-completion. For example, acquirors in M&A transactions should conduct additional diligence and monitoring once they have gained unrestricted access to the target post-completion. Parties to other types of corporate transactions also should monitor the compliance of their counterparty for the duration of the business relationship.

When sanctions and export controls risks have been identified during diligence, early consideration of the resources required to conduct ongoing diligence and compliance monitoring that meet regulators' expectations is critical. Such post-completion efforts might include:

- Appointing management personnel strongly committed to compliance to