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13 Compliance Questions to Enhance Diligence and Integration in Non-Controlling Transactions

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With all the processes and systems built around handling corporate transactions, it is easy to forget that, at heart, corporate transactions create business relationships between parties to the transaction. Keeping this in mind can help companies manage transaction costs and risk. From an anti-corruption risk management perspective, appreciating the nature of the relationship that results from particular types of corporate transactions helps ensure that risk management steps are closely aligned with business realities.

This article discusses some of the transaction vehicles businesses have been deploying to meet these goals, and it provides key check-in questions that can serve as a frame of reference for deal team compliance resources to ensure due diligence findings are appropriately assessed and incorporated into an integration plan in non-controlling strategic transactions.

Spectrum Between Arm's-Length and Controlling-Stake Acquisition

At one end of the spectrum, the result of a transaction is an arm's-length relationship in which parties continue to operate separately to achieve time-and-scope limited objectives of a particular agreement, and anti-corruption risk management is more likely to be approached through the company's existing third-party or business partner process. On the other end of the spectrum, a company's M&A risk management process is more likely to bear the responsibility for evaluating the risks arising where the buyer steps into the seller's shoes with respect to the range of anti-corruption risks presented by the target's business relationships and operating history.

The current volatility of the marketplace, however, means that the transactions companies are engaging in do not always fall neatly into one or the other of these two types. Achieving business goals in this environment requires striking a balance between an increasing need for flexibility, on the

one hand, and dependability and exclusivity of business relationships, on the other. Collaboration and joint development agreements, minority stake investments, minority joint ventures (JVs) and other non-controlling transactions are helping businesses meet these objectives.

See the two-part series on FCPA Evolution through an M&A lens: "How M&A Impacted FCPA Enforcement and Guidance" (Jan. 20, 2021); "The Compliance Value-Add" (Mar. 3, 2021).

Transaction Vehicles That Maximize Flexibility

Inflationary pressures and stock market volatility are strong incentives to defer significant corporate transactions until things stabilize. Waiting, however, may not always be an option. In highly competitive industries, waiting risks being left behind by competitors. Even in less competitive industries, geopolitical tension, growing demands from regulators, the need to adapt to new technologies, and production stoppages due to COVID-19 have forced companies to adapt supply chains to new and evolving needs. This is an unusual business environment where one of the few "knowns" is change and companies increasingly need flexible relationships with dependable partners.

In volatile business environments such as the current one, a company may know that it needs to move quickly and perhaps pursue parallel strategies to maximize chances of success. It may wish to adopt multiple strategies knowing that only one or a few will be successful. Thus, transaction vehicles characterized by a smaller upfront capital outlay, low barriers to exit relationships if things go wrong, and opportunities to lock in relationships if the strategy proves successful are highly valued. If the pressures and motivations for pursuing a particular strategy are industry-wide, then a company will likely also face stiff competition from peers to find partners that are interested in this type of relationship and have the appropriate operational, financial and reputational profile. Even established companies considering entering relationships with start-ups and other less established entities may find their bargaining power weakened by this "seller's market" and will undoubtedly have to act quickly or face missing out.

Consider, for example, Ford Motor Company's minority stake investment in EV manufacturer Rivian. In 2019, when Ford made its initial equity stake acquisition, the two companies planned to jointly develop electric vehicles under Ford's brand. As part of the strategy, Ford's President of Automotive at the time joined Rivian's seven-member board. By the end of 2021, however, Ford's in-house electric vehicle program had developed to the point where the company no longer felt joint development with Rivian was the best strategy and vehicle collaboration plans were scrapped. Ford has since sold approximately 8% of its stake in the automaker, which today is a competitor in the electric-truck market.

Faced with uncertainty regarding what EV strategy would be successful, Ford invested in multiple strategies (*e.g.*, in-house development and minority stake acquisitions). In the case of Rivian, Ford adopted a transaction vehicle – minority stake acquisition and joint development – that provided a clear and readily available exit as the company's path forward in the EV market became clearer. Non-controlling strategic transactions such as these may be attractive to businesses when flexibility is a primary consideration.

Practical Challenges

From an anti-corruption risk management perspective there are several practical challenges with which a compliance department must grapple, particularly when non-controlling strategic transactions involve international partners. Oftentimes, partners in these types of transactions are unknown quantities operating in little understood emerging technologies and, particularly as companies seek to diversify supply chains, located in geographic regions with which the business has less experience. It is not uncommon for prospective partners to be new enterprises that do not to have a compliance program, or to have only a high-level code of conduct.

Of course, for entities that have been operating for a long time, the lack of experience in the particular activity and the lack of a compliance program ordinarily would heighten the risk profile of the prospective partner company, but for a new business little can be gleaned from these facts beyond the party's inexperience with corporate compliance programs. Instead, due diligence regarding the key executives of the counterparty becomes an even more critical piece of the assessment, and eventual risk management plan.

Regardless of whether the target is a new company or one with a longstanding history, however, compliance departments are better able to perform due diligence, respond to diligence results and develop an anti-corruption risk management plan that meets their company's narrow time windows and commercial needs if compliance efforts are geared towards the nature of the relationship created by the transaction and the legal risks associated with that relationship.

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

Assessing the Legal Risks

Broadly speaking, anti-corruption compliance risk in corporate transactions can fall into three categories:

1. the possibility of successor liability based on the target entity's pre-transaction misconduct;
2. the continuation of undiscovered misconduct by the target following closing; and
3. the acquisition itself involving a violation of law.

Depending on the nature of the transaction, one or more of these risks can be relevant to varying degrees.

The first of these risks, successor liability, is not a core issue in non-controlling strategic transactions. The U.S. corporate law principle that an acquirer assumes liabilities of acquired entities regardless of whether it knew of those sources of liability before the transaction is not applicable in non-controlling strategic transactions. Yet, companies often take their M&A anti-corruption risk management approach and scale it down for other types of transactions including those where suc-

cessor liability is not at issue (*e.g.*, minority JVs, joint development agreements, minority stake acquisitions and other alliances). This can result in misallocation of resources and an inaccurate appreciation of the actual risk posed by a particular transaction.

This is not to say that assessment of pre-transaction misconduct is irrelevant in non-controlling strategic transactions. Evidence of pre-transaction misconduct may be an indicator that the target will engage in post-transaction misconduct for which the acquirer may be liable. Likewise, where a counterparty contributes assets to a venture, such as contracts, and those assets were obtained through bribery, the acquiror/partner could be liable for any acts in furtherance of the original bribery.

The assessment of instances of pre-transaction misconduct, however, is different. Where successor liability is not a factor, instances of pre-transaction misconduct are an indication of potential future sources of liability rather than a consummated source. The crucial question for compliance resources in such transactions is whether the prior misconduct has been appropriately remediated. Unremedied misconduct is likely to repeat itself, or could result in the company acquiring or being exposed to an asset tainted by prior misconduct. This approach reflects the reality that, following an integrity near miss or an all-out integrity crisis, companies often reinvent themselves and become reliable partners.

Finally, the transaction itself, or steps taken to conclude the transaction, could be a violation of the FCPA. For example, a transaction may require a local regulator's approval prior to completion and any payments made in order to improperly secure that approval would be a violation. Likewise, if the counterparty's beneficial owner is a non-U.S. government official, sufficient vetting and the establishment of adequate controls and mitigation measures must be considered to ensure that entering into the business relationship does not constitute conferral of an improper benefit to that beneficial owner in violation of the FCPA.

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).

Check-In Questions

It is essential that compliance personnel work closely with deal teams if they are to successfully implement appropriate anti-corruption risk management measures in non-controlling strategic transactions. A crucial contribution the compliance resource can make during the transaction process is to ensure that the desktop research, target company questionnaire responses, and, where applicable under the company's process, discussions with the counterparty all inform a broader assessment and integration planning based on the nature of the relationship created by the transaction (*e.g.*, joint venture, coordinated technology development, simple supply relationship).

Keeping a view of the "big picture" will not only be appreciated by the business but will also keep the process on target and enable compliance personnel to appropriately assess any adverse findings

in a due diligence process. The check-in questions below are designed to help compliance resources assess adverse due diligence findings through the lens of the two primary compliance risks at play in non-controlling strategic transactions: liability for future misconduct, and the transaction itself violating the law.

Viewing due diligence and integration through this lens helps compliance personnel ensure that their assessment of adverse due diligence findings is properly contextualized to the particular transaction. Of course, these check-in questions are intended as a frame of reference to augment, not take the place of, a company's existing due diligence and integration policies and procedures and standard compliance clauses:

1. Does the adverse finding raise questions about the integrity of the counterparty's key executives, or individuals that will be involved in the ongoing relationship with the company? Such findings may include those related to fraud, embezzlement, conflicts of interest or corruption.
2. What additional information, if any, would I need to understand if this is an ongoing or remediated issue?
3. Have relevant media reports or rumors been substantiated? What steps can be taken to assess the veracity of media reports of potential misconduct?
4. What would it take to remediate this issue, and how soon could remediation be achieved?
5. Would senior leadership (either of the counterparty or a joint enterprise) support implementation of compliance program enhancements? This assessment may be based on the company's past efforts to implement a compliance program or an expressed desire of the company to align with international practices. Of course, adverse findings related to the integrity of leadership may undercut commitment to implementing compliance enhancements.
6. Are identified compliance program gaps typical for a company of that size or in that industry or geography, or do they reflect a lack of commitment to compliance?
7. How would any compliance program gaps impact our activities with the partner? Are there any reputational risks to our company that are more likely because of the compliance program gaps?
8. Would the counterparty be willing to adopt our compliance program, or key elements of our compliance program?
9. How would enhancements to the counterparty's compliance program be implemented? What resources would be necessary?
10. What oversight role will our company have on an ongoing basis (*e.g.*, board seats, seconded personnel in key functions), and how can it be leveraged to ensure the venture has adequate internal controls? Compliance should collaborate closely with the finance function on these issues.
11. Do any of the adverse findings suggest areas where we would want to have veto power or control in the ongoing relationship?

12. To the extent necessary, can the agreement incorporate language requiring implementation of necessary remediation of adverse due diligence findings and compliance program enhancements?
13. Did running relevant individuals at the counterparty or third parties involved in completing the deal through our third-party or business-partner due diligence tool identify potential government connections?

Asking these check-in questions will enhance the compliance professional's contribution to the deal team by allowing adverse due diligence findings to be distilled in terms of concrete risks to the company and possible steps to mitigate or get comfortable with those risks. It will also enhance the effect of the company's policies and procedures regarding due diligence, integration, and risk-based compliance contract clauses by making use of the results of these company processes in a meaningful way.

Finally, framing due diligence findings and necessary integration steps in terms of the two relevant sources of compliance risk in non-controlling strategic transactions will enhance the credibility of the compliance team's assessment with business leaders and other stakeholders by using terms they will understand and avoiding overreaction to potential red flags.

See the Anti-Corruption Report's 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).

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