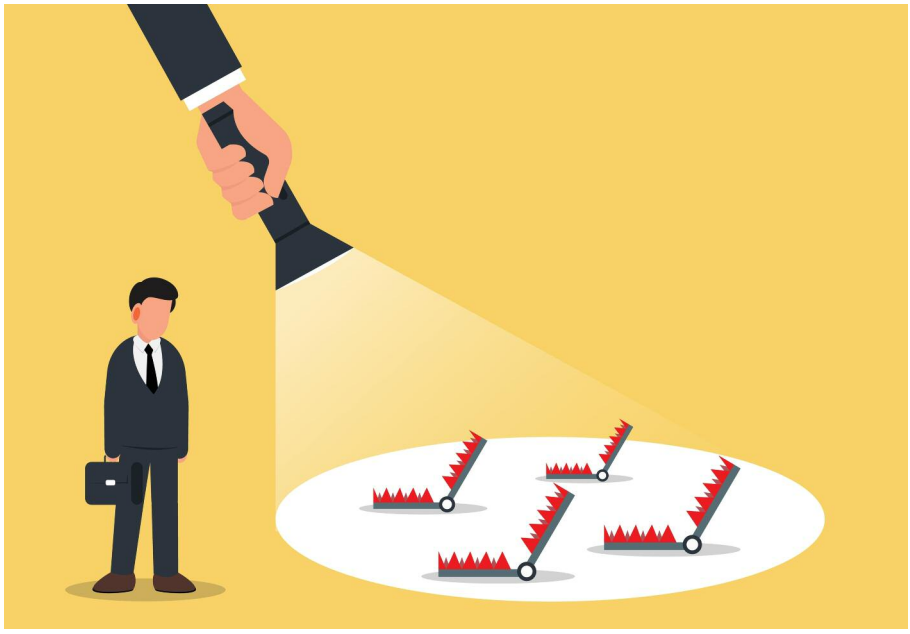

STEPTOE OUTSIDE COUNSEL

Due diligence for M&A: how (and why) to get it right

The past year has witnessed a major boom in corporate activity, with the value of announced M&A transactions shattering previous records. Competition for corporate transactions is intense, and deal timelines are often short, but appropriate due diligence – including export control and sanctions diligence – is still a crucial part of managing compliance risks. This article (the first in a two-part series) discusses the importance of diligence on sanctions and export control issues, and outlines best practices for conducting effective due diligence on these topics.

Risks are on the rise

The potential for sanctions and export control issues in a corporate transaction is growing, as parties today are increasingly likely to have sales or business operations that cross national borders. An M&A target that has US-origin items in its supply chain may be subject to the export control regulations of the United States as well as its home country. Export controls and sanctions are also being deployed to address an increasingly wide range of policy concerns, including forced labor, other human rights abuses, corruption, cybersecurity and ransomware, and data protection.

Moreover, the complexity of sanctions regimes continues to grow, which can result in interweaving and sometimes conflicting compliance obligations. For example, non-US companies could be required to follow certain US sanctions requirements based on ownership or control by a US parent, and US "secondary sanctions" introduce risks for non-US companies that transact with some US sanctions targets even absent a US connection to the transactions.

> Careful attention should be paid to how the transaction will affect the target's existing compliance program.

The introduction of the UK's autonomous post-Brexit sanctions regimes has increased compliance complexity for companies operating in both the United Kingdom and the European Union. "Blocking statutes" or other anti-sanctions measures that seek to prevent the extraterritorial reach of some sanctions also have been strengthened in the EU and UK, and have also been adopted in China and Russia.

The benefits of diligence

Export control and sanctions diligence can help the parties ascertain the proper value of a transaction by identifying issues that may warrant a price adjustment or that could even be fatal to the deal. Diligence can also help an acquirer reduce its risk of civil or criminal penalties founded on successor liability, direct liability (stemming from any ongoing violations post-completion), or ancillary liability under other laws such as those targeting money laundering.

Instances of non-compliance with sanctions and export controls, if not detected through diligence, can also cause reputational harm.

Scoping and conducting diligence

Early consideration should be given to whether diligence should be conducted through external counsel. For example, it is prudent to do so in jurisdictions that limit or do not recognize attorney-client privilege for in-house counsel. Compliance and legal personnel and/or external counsel should also consider discussing expectations early with the deal team, to ensure a shared understanding of which compliance issues are "red lines" that could be fatal to the transaction.

To aid in scoping the diligence, it is prudent to assess the risks of the target and the transaction, by asking questions such as:

- To which countries' sanctions/export controls regimes does the transaction have a nexus?
- Are items subject to export controls restrictions involved?
- Are sanctioned or restricted end-users or end uses involved?
- Does the transaction implicate other trade control areas, such as anti-boycott rules?
- Does the target have an effective sanctions/export controls compliance program?

Careful attention should also be paid to how the transaction will affect the target's existing compliance program. For example, if the transaction is a carveout or spinoff, which compliance functions will be carried over to the new entity and which will be left behind (and will therefore need to be replaced)?

Initial diligence requests should be informed by the risk assessment. In addition to seeking general information on the target's business activities and compliance program, the requests should

Reprinted with permission from the December 2021 issue of Export Compliance Manager.
www.exportcompliancemanager.com