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Successor liability: Stamping out corruption is good for business

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The responsibility to "clean up" corrupt business practices in the developing world has more often than not fallen to foreign-based investors as opposed to the authorities in those countries. Unlike local shareholders, multinational investors are exposed to the extra-jurisdictional reach of anti-corruption laws in their home countries and must take care when taking on new investments in corrupt countries.

However, this desire to clean up business practices is no longer driven solely by compliance or regulatory expectations. There is an increasing "ethical" expectation from shareholders and other stakeholders to stamp out corruption in far-flung parts of an organisation.

Corruption reduces the efficiency and competitiveness of the marketplace, meaning fewer opportunities for business from new investors. Bribes are the antithesis of a long-term approach: they can only ever be a short-term fix, storing up further problems down the road. Bottom lines will ultimately be boosted by making clear that corruption is unacceptable: it will encourage better behaviour and create a platform for sustainable long-term investment. Tackling corruption is good for business.'

The risks

When a business acquires a target company, the new shareholder is potentially exposed to the liabilities, both known and unknown, of the target company. This primarily relates to investment value but in some cases can even extend to civil and criminal liability for acts committed by the target company prior to the acquisition/investment. Investors can find themselves faced with a matrix of liabilities stemming from multiple jurisdictions.

By way of example, under the UK Bribery Act (UKBA), a company carrying on a business in the UK (whether it is incorporated in the UK or not) faces a strict liability offence for failing to prevent bribery anywhere in the world by its subsidiaries and employees of those subsidiaries; even if such bribes were not sanctioned or even known about. Generally, under English law, parent companies are not criminally liable for the past acts of newly-acquired subsidiaries. However, they will inherit bad business practices which can expose them to on-going liability unless practices are cleaned up. There are also Proceeds of Crime risks for UK based companies if the profits of investments are earned from historic tainted contracts.

And, in the U.S., the Department of Justice (DoJ) announced a focus on successor liability earlier this year in a speech given by Deputy Assistant Attorney Matthew Miner. The DoJ and the Securities and Exchange Commission (SEC) take the view that a company subject to the Foreign Corrupt Practices Act may be criminally liable for the actions of a subsidiary that continue after the acquirer takes ownership.

Several jurisdictions, including China, India, Japan, and Singapore, have introduced new laws to tackle corruption this year. Parent companies of international subsidiaries are increasingly exposed to the risks of successor liability from numerous angles: they cannot disassociate themselves from problems outside their own jurisdictions.

More than just contractual protections — a robust approach is needed

While successor liability risks can be factored into the acquisition/investment process using traditional methods (such as price adjustment, warranties, indemnities, insurance, or restructuring into an asset sale), many of the consequences of bribery for a new shareholder (including corporate criminal prosecution, fines, legal fees, disgorgement of dividends and reputational damage) are highly unpredictable, rendering the above fixes, if used alone, insufficient.

The difficulty in quantifying successor liability risk means that businesses need to protect themselves by undertaking thorough anti-corruption risk assessments and due diligence before entering into an acquisition.

Once an acquisition has completed, the clean-up operation can begin. Shareholders should implement appropriate procedures including robust policies, training, formal due diligence on third parties, monitoring, and financial controls. Most crucially shareholders must understand new risks by conducting a thorough bribery risk assessment. The extent of this process will depend on the particular jurisdictional risks associated with target companies. Businesses' existing policies may be inadequate to deal with the fact that corrupt practices are systemic and culturally embedded.

There are important benefits to this thorough approach. Having "adequate procedures" in place to prevent bribery is a defence to the UKBA corporate offence and DoJ will treat businesses actively working to tackle corruption in new subsidiaries more favourably. Moreover, as Transparency International has reported, robust ABC policy monitoring indicates that a company has reliable and measurable indicators in place to track internal operations, creating a *"virtuous cycle"* whereby reporting is used to gain a better understanding of core business processes in order to improve them internally.[1] Increasingly, both customers and shareholders expect more by way of ethical policies and procedures: companies can reap the benefits of both increased business and increased investment.

If you do not do so, the risks are clear: having entered into a settlement in excess of US$100 million for bribery offences in 2009, a multinational mining conglomerate failed to learn its lessons – leading to further penalties in the region of US$30 million for FCPA violations by an

African subsidiary last year. More broadly, research indicates that it costs a company an average of US$222 per employee to comply with the law whereas it costs US$820 per employee for not complying.[2]

Conclusion

It is in businesses' best interests to thoroughly investigate target companies and implement robust anti-corruption policies post-acquisition. Simply pricing in successor liability risks using traditional methods is not sufficient to protect a business, or the value of an investment, from the long term effects of bribery.

By reducing corruption, acquirers contribute to the invigoration of local economies, increasing the sustainability of business in those jurisdictions and maximising their long-term profitability.

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[1] Transparency International (2016). *Working Paper #1 2016: The Benefits of Anti-Corruption and Corporate Transparency*. Available here.

[2] Ponemon Institute (2011), *The True Cost of Compliance: A Benchmark Study of Multinational Organizations*. Available here.

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