DOJ and OFAC Actions Highlight Importance of Compliance in International M&A

Written by Gwendolyn Wilber Jaramillo, Shrutih V. Tewarie, Nicholas Anastasi

April 17, 2019

Summary and Action Alert

Recent actions taken by the Department of Justice ("DOJ") and the Department of Treasury's Office of Foreign Assets Control ("OFAC") have highlighted the importance of due diligence in the mergers and acquisitions context.

In February and March of 2019, OFAC published three separate notices of settlements related to persistent wrongful conduct of foreign subsidiaries of U.S. entities in violation of U.S. economic sanctions. OFAC is emphatically telegraphing its focus on pre-acquisition due diligence and aggressive post-acquisition implementation of global compliance programs by U.S. acquirers.

The DOJ has also recently put a spotlight on the importance of due diligence in the mergers and acquisitions context. On March 8, 2019, it announced revisions to its Foreign Corrupt Practices Act Corporate Enforcement Policy (the "DOJ Policy"), which was first released in 2017. These revisions encourage companies to conduct pre-acquisition due diligence and to promptly self-disclose any uncovered misconduct to the DOJ. Companies that comply with the revised policy will be eligible for a presumption of a declination in accordance with and subject to the other requirements in the DOJ Policy.

OFAC Enforcement Actions

1. Stanley Black & Decker: Post-Acquisition Training No Substitute for Audits and Monitoring

On March 27, 2019, OFAC announced a settlement with Stanley Black & Decker, Inc. and its Chinese subsidiary, Jiangsu Guoquiang Tools Co. Ltd. ("GQ Tools") under which Stanley Black & Decker agreed to pay over $1.8 million for sanctions violations committed by the foreign subsidiary in violation of Iran sanctions – in short, intentionally making or attempting to make 23 shipments of tools worth $3 million, either directly or indirectly to Iran.

OFAC's penalties were imposed in spite of multiple steps taken by Stanley Black & Decker to guard against sanctions violations by its new subsidiary prior to and following the acquisition of GQ Tools:

- In pre-acquisition due diligence, Stanley Black & Decker undertook due diligence and learned that GQ Tools was exporting goods to Iran.
- Stanley Black & Decker required GQ Tools to cease sales to Iran as a prerequisite to closing and provided a series of trainings to GQ employees on U.S. sanctions compliance.
- Upon learning of the post-acquisition violations, Stanley Black & Decker halted all GQ Tools exports, voluntarily self-reported the violations, hired an independent investigator, conducted an internal investigation, and signed multiple tolling agreements to extend the statute of limitations during OFAC's investigation.

The U.S. parent company's failure to implement post-acquisition procedures to monitor or audit GQ Tools' operations to ensure no recurrence of Iran-related sales weighed against the compliance efforts that had been made; in addition, GQ Tools was a sophisticated company with a history of extensive export operations, and its management willfully violated the Iran sanctions. The settlement agreement explicitly highlighted "the importance for U.S. companies to conduct sanctions-related due diligence both prior and subsequent to mergers and acquisitions, and to take appropriate steps to audit, monitor, and verify newly acquired subsidiaries and

affiliates for OFAC compliance."

2. Illinois Tool Works, Inc.: Extensive Misconduct by Foreign Subsidiary Continues Even After Voluntary Disclosure to OFAC

On February 14, 2019, OFAC published a settlement agreement assessing a civil monetary penalty of approximately $5.5 million against AppliChem GmbH, a foreign subsidiary of a U.S. company, Illinois Tool Works, Inc. ("ITK"), for violations of Cuban sanctions by AppliChem's Spanish branch, occurring over the course of four years after AppliChem's acquisition by ITK. These violations occurred despite ITK's pre-acquisition due diligence and closing requirements that AppliChem cease the Cuba business. Even after ITK discovered some violations (shipments of chemical reagents to Cuba) and voluntarily disclosed them to OFAC, the illegal shipments continued for two more years with the complicity of AppliChem's Spanish management.

In making the decision to fine AppliChem despite ITK's efforts, OFAC cited:

- The willful conduct of AppliChem's management.
- The size and sophistication of AppliChem.
- The size and international sophistication of ITK.
- ITK's failure to initiate a full internal investigation after AppliChem employees reported indications of continued sales to Cuba.

3. Kollmorgen Corporation: Foreign Affiliate Continues Iranian Sales Post-Acquisition Despite "Extensive Efforts" by U.S. Parent to Require Compliance

A settlement with Kollmorgen Corporation published on February 7, 2019 is even more sobering, despite the small dollar amount ($13,381). Kollmorgen is a U.S. company that had acquired Elsim Elektroteknik, a Turkish entity, and undertook "extensive efforts" (as OFAC recognized) to ensure that its new affiliate complied with U.S. sanctions laws. These were unsuccessful – post-acquisition, over the course of two years, Elsim knowingly continued to provide services in violation of the sanctions to machines in Iran, and to provide products, parts, or services valued at $14,867 to Iranian end-users. Despite the low dollar value of these services, the potential initial fine was $750,000 – however, due to Kollmorgen's extensive post-acquisition compliance efforts, and its voluntary self-reporting of misconduct and remedial actions, this penalty was reduced to $13,381. This amount, of course, does not include the assuredly heavy legal and investigative fees that were paid by Kollmorgen to achieve that result.

DOJ Policy Revisions

The DOJ Policy revision follows a series of public guidance provided by the DOJ on the importance of FCPA due diligence in the M&A context. In 2012, the DOJ and the SEC issued a "Resource Guide" to the FCPA, which used real-world examples and hypotheticals to provide concrete direction about key FCPA issues. This guide includes a section on M&A due diligence, which includes practical tips to reduce FCPA risk such as conducting thorough risk-based FCPA and anti-corruption due diligence on potential business acquisitions, and conducting trainings for directors, officers, and employees of newly acquired businesses, among others.

As one real-world example, in 2008, the DOJ issued an opinion at the request of Halliburton regarding a potential acquisition of a U.K.-based company. Based on the nature of the U.K. bidding process, Halliburton would not have been able to engage in adequate FCPA due diligence prior to the acquisition. As a result, Halliburton submitted a request for an opinion from the DOJ regarding its liability after closing for any of the target company's pre-acquisition conduct that violated the FCPA, in which it pre-emptively proposed to undertake a demanding post-acquisition plan. The DOJ agreed not to take any enforcement actions against Halliburton for any pre-or post-acquisition conduct by the target company, but in exchange required Halliburton to agree to a rigorous post-acquisition due diligence and remediation plan. Then, in 2016, the DOJ initiated a program under which it announced a handful of scenarios in which a company may receive a declination, including voluntary disclosures of misconduct and otherwise cooperating with investigations.

In 2017, the DOJ released an updated policy to further incentivize voluntary self-disclosure and cooperation with investigations. Under this policy revision, the DOJ offered an express presumption of declination to prosecute companies that voluntarily disclosed misconduct, cooperated with investigations, and appropriately remediated the situation and made restitutions or otherwise disgorged all illicit profits. The latest policy revision clarifies that acquiring companies can rely on a presumption of a declination if they act in accordance with the DOJ Policy both pre-and post-acquisition. This would include conducting appropriate due diligence and promptly self-disclosing any uncovered misconduct to the DOJ and otherwise complying with the DOJ Policy on cooperation and remediation.

Key Takeaways

- OFAC could not be more explicit in its messaging regarding the importance of not just pre-acquisition due diligence, but post-acquisition training, monitoring and auditing for violations, and voluntary self-disclosures. Finding resources to fully implement the necessary compliance and monitoring systems right upon closing is vital.
- Penalties are likely to be reduced for good responses to violations and cooperation with investigations by OFAC, but this will not lessen the pain and cost of the investigation and legal advice required to respond to these events. Repeat offenders will not be given multiple tries to "get compliance right."
- U.S. acquirers should engage in extensive due diligence when acquiring foreign entities, in particular those suspected to have relationships with sanctioned entities or with FCPA risk. In addition, the U.S. parent must remain vigilant post-acquisition, and should proactively take necessary precautions including internal audits to keep apprised of violations. Upon learning of any violations, companies should undertake mitigating steps including voluntary self-disclosure, cooperation with investigations, and timely remediation in order to maximize the possibility of penalty mitigation or declination.

Resources

- The full text of the DOJ policy revision can be found here.
- The discussed OFAC settlement announcements can be found below:
    - Kollmorgen Settlement Agreement
    - AppliChem GmbH Settlement Agreement
    - Stanley Black & Decker Settlement Agreement

RELATED PRACTICES

- Mergers & Acquisitions
- Trade Sanctions & Export Controls
- Business Counseling
