New DOJ policy: Safe harbor for self-disclosure of misconduct discovered during the M&A process

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New guidance

On October 4, 2023, the United States Department of Justice (DOJ) announced its new Safe Harbor Policy that encourages companies to voluntarily self-disclose criminal misconduct discovered at an entity acquired through a merger or acquisition (M&A) transaction. This new DOJ policy provides that companies that comply with the safe harbor requirements will receive a presumption of declination from disclosed criminal misconduct. This policy is being applied across all DOJ departments, including the Foreign Corrupt Practices Act (FCPA) unit, which is responsible for pursuing enforcement actions associated with successor liability for FCPA-related misconduct by a predecessor. The safe harbor requirements include disclosing criminal wrongdoings at the acquired company within six months of the deal closing, cooperating with the DOJ during its investigation and fully remediating the misconduct within a year of the deal closing, although both time frames are subject to reasonableness tests and could be extended by DOJ officials. It is important to note that the timeline applies whether the misconduct was discovered pre- or post-acquisition. In the DOJ's official announcement, Deputy Attorney General Lisa Monaco stated, "The last thing the department wants to do is to discourage companies with effective compliance programs from lawfully acquiring companies with ineffective compliance and a history of misconduct." This new policy puts a finer point on the value an acquirer can gain from addressing legal and compliance concerns at an acquired entity and promptly putting an end to criminal behavior.

> "If your company does not perform effective due diligence or self-disclose misconduct at an acquired entity, it will be subject to full successor liability for that misconduct under the law.
>
> – Deputy Attorney General Lisa O. Monaco
> October 4, 2023

What is the impact?

Companies with effective compliance programs are afforded greater protections from DOJ enforcement actions when engaging in M&A activity when criminal misconduct is promptly identified, disclosed, and redressed at an acquired entity. This new safe harbor is another incentivization offered by the DOJ consistent with revisions to its corporate enforcement policy announced earlier in January related to voluntary self-disclosure, cooperation, and remediation. These DOJ policies aim to encourage companies to proactively address misconduct and strengthen their compliance programs.

Previously, companies may have been discouraged from acquiring entities with past criminal misconduct due to the prospect of inherited legal risks, namely the threat of prosecution with hefty financial consequences. However, this significant looming threat can now be mitigated under the safe harbor policy. Unless aggravating factors exist, both the acquirer and the acquired company could qualify for applicable self-disclosure benefits, including potential declination.

In addition to prosecutorial benefits under the safe harbor policy, performing pre-acquisition due diligence has two other significant benefits.

1. **Advanced integration planning:** The SEC and DOJ continue to evaluate whether the acquiring company promptly incorporates the acquired entity into its compliance program and internal controls framework. Understanding regulatory issues and compliance activities during pre-acquisition due diligence enable the acquirer to get a head-start on how it can quickly enfold the acquired entity into its compliance activities and controls.
2. **Deal value:** Having a compliance mindset during due diligence is key. Not fully understanding the current implications of potential misconduct at a target and the long-term investment needed to remediate it can be a financial burden for the acquirer if it is not quantified and factored into the deal value. Knowing such factors upfront and incorporating them into the parameters of the deal, including the purchase price, representation and warranties clauses, and contractual remedies, can mean greater success in unlocking the deal value.

What can be done?

Conduct thorough due diligence: Perform comprehensive compliance due diligence to (1) identify potential misconduct and higher-risk activities, relationships and transactions, and (2) evaluate gaps or weaknesses in the entity's compliance program. The time needed to obtain applicable information from the target entity, conduct diligence procedures, and navigate potential issues can be lengthy, so starting due diligence during the pre-acquisition phase is advantageous for the acquirer. Tight deal timelines and limited access to information are two real challenges companies face in performing pre-acquisition due diligence. To the extent that diligence is limited during pre-acquisition, perform diligence and compliance-specific audits at the acquired entity as quickly as practicable post-acquisition.

Focus on integration and remediation: DOJ has communicated the expectation for "timely post-acquisition integration."[1] Acquirers should have a robust integration plan in place to implement the acquiring company's code of conduct and compliance policies as quickly as practicable and conduct compliance training for the acquired entity's directors, employees, and significant business partners. To the extent that diligence is limited during pre-acquisition, it is advisable to perform diligence and compliance-specific audits at the acquired entity as quickly as practicable post-acquisition.

Engage the appropriate stakeholders and advisors: Collaborate closely with legal and financial experts to identify and understand the impact of potential compliance issues, and the broader implications of voluntary self-disclosure to the DOJ.

How can we help?

Compliance due diligence should be an inherent component of the deal process and tailored to the target entity's specific regulatory and compliance risk profile. The EY Forensic & Integrity Services practice has deep subject matter resources and capabilities in the many diligence areas within compliance, including, but not limited to:

1. Anti-fraud and money laundering screening
2. Anti-corruption diligence activities
3. Business intelligence/background investigations
4. Third party sanctions screening
5. Global trade and export controls assessment
6. Government contract compliance diligence
7. Conflicts of interest assessment
8. Management expense/benefit analysis
9. Insider threat assessment
10. Targeted forensic analysis around fraud risk indicators

The DOJ Safe Harbor Policy and the potential advantage of prosecutorial declination it offers for self-disclosure of misconduct at acquired entities is another benefit companies can add to the list of reasons to incorporate compliance due diligence into their M&A deal process.

[1] Deputy Attorney General Lisa O. Monaco Announces New Safe Harbor Policy for Voluntary Self-Disclosures Made in Connection with Mergers and Acquisitions," Lisa O. Monaco, U.S. Department of Justice website, October 4, 2023

> "Given the complex nature of multinational organizations, the six-month baseline for disclosure can pass quickly. It is in the Buyer's best interest to begin thorough, compliance-focused due diligence as early in the deal process as possible.
>
> – Cory Rogers, Managing Director, EY Forensic & Integrity Services, Ernst & Young LLP

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