Ferreting Out Risk Before the Deal Is Done

Due Diligence during a Merger and Acquisition

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Most companies understand that prior to any Merger and Acquisition ("M&A") a grueling due diligence process will take place. This process can result in a difficult series of tiny, demanding problems for those unfamiliar with the process, or those caught unprepared. There are a seemingly infinite number of items that must be disclosed and information made available, and to make the bridge happen, both parties must meet each other's demands in a timely manner to ensure a smooth transition without animosity or strife.

Out of the hundreds of things that must be considered when performing due diligence, some of the most important are the most often ignored.

What is missing from most companies' due diligence process are requests for copies of all written materials, or summaries if written materials do not exist, relating to import compliance policies, procedures, programs and problems. Any deviations from these policies and programs must be turned over to the acquiring entity. A company should be required to list all questionable transactions within the last five years, which stray from these policies, and also explain how policies are written, reviewed, updated and audited.

Specific documentation should also be provided for conditionally free or special tariff classifications used for merchandise, such as NAFTA or American Good Returned. The process used to establish NAFTA qualifications should be explained. The company should be asked to provide the correct country of origin for products, as well as the correct country of export; you should understand how long certain processes have been in place and what efforts have been made to prevent or deal with the commingling of products relative to any declarations made to U.S. Customs & Border Protection.

All documents normally kept in the ordinary course of business, such as bills of lading, commercial invoices, entry records, statements, declarations, documents/papers, correspondence, accounts and accounting documents, financial statements, journals, lab tests, and technical data, should be maintained for a minimum of five years, and be readily available. This means they must be retrievable within 30 days. If this is not the case in the company to be acquired, the situation must be explained. Further, certain government preference programs require documents to be maintained longer than five years, so a critical issue to understand is when and under what conditions critical documents (paper and electronic) are destroyed.

All international shipping terms used to define obligations regarding risk of loss associated with the international transportation of goods should be listed, and the way in which invoices and freight costs are declared and reconciled should be established. If a company is a member of the Customs-Trade Partnership Against Terrorism, then they should list all supply chain security in place, and identify all initiatives undertaken in the past three years.

Similar scrutiny during due diligence needs to be paid to the acquired company's export process. A company should describe all transactions in the past five years in which the company exported any military items, pharmaceuticals, nuclear products, encryption-related items, ships and marine products, toxic substances, chemicals, electric power, endangered species products or dual-use items. Dual-use items are those items that have both a commercial and military application and, therefore, may have required an export license.

Written documentation for any transactions conducted with any individuals or entities in the past five years listed on the following U.S. government lists should also be provided: the Denied Persons List, the Unverified List, the Entity List, the Debarred List, and the Specially Designated Nationals List.

Additionally, any company that has conducted business with any individuals, entities, or governments sanctioned by the Department of Treasury's Office of Foreign Assets Control ("OFAC") should also provide written documentation about these dealings. Currently, these sanctioned countries include the Balkans, Myanmar, Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sudan, Syria, and Zimbabwe. Evidence of training and audit programs designed to assure compliance should also be provided.

A company must list foreign employees and foreign visitors that have had access to restricted information, software or technology. A company's policy for dealing with foreign nationals and deemed exports must also be explored. The company's customers, suppliers, and business associates that are owned, in whole or in part, by a foreign government must be listed. All documents related to a company's Foreign Corrupt Practices Act compliance policy should be provided.

A company must also explain its document retention policy over exports, and confirm that all required export documentation is maintained per relevant regulations. Any deviations in the past five years must be explained.

If in the past years a company has been charged with, investigated for, or convicted of any import violation, export control, economic sanctions, or FCPA violations, they must provide documentation surrounding the event. If there is any evidence of potential diversion, evasion, or shipment of products in contravention of export control regulations, this must also be addressed. All documents should be provided, including a description of the resolution, disposition, or status of such matters.

While this due diligence warning only scratches the surface, it is important to have import/export legal counsel as part of the M&A process. The above suggestions will give companies a place to start and areas to address as they move forward. A company should always be ready to disgorge its critical documents and have a comprehensive system in place for maintaining, auditing and retrieving them.

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