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DOJ announces new guidance for disclosure of misconduct in the M&A context

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On Wednesday, Deputy Attorney General Monaco announced new DOJ guidance providing a safe harbor to avoid criminal prosecution for companies that identify and disclose misconduct that occurred at an acquired entity. To qualify, the disclosure must occur within six months of the acquisition and the misconduct must be fully remediated within one year of the acquisition. While welcome, the safe harbor announcement presents companies and defense counsel with many issues to carefully consider.

The M&A due diligence guidance

During a speech at the Society of Corporate Compliance & Ethics conference on October 4, Deputy Attorney General (DAG) Lisa Monaco announced new guidance relating to misconduct discovered in connection with an acquisition. According to the guidance, every DOJ division must make available a safe harbor to acquiring companies that, during the course of pre-acquisition due diligence or post-acquisition integration, discover and disclose misconduct occurring at a target. To avail itself of the safe harbor, the acquiring company will need to disclose the misconduct to the DOJ within six months of the closing and fully remediate the misconduct within one year of the closing. In addition, the company will need to pay full restitution to any victim and disgorge any profits received from the misconduct. If the acquiring company satisfies these conditions, it will enjoy the presumption of a declination for the criminal misconduct (meaning the DOJ will not bring any criminal enforcement action), even if the misconduct at the target entity involves aggravating circumstances, such as high-level executive involvement in the misconduct. Moreover, misconduct disclosed under the safe harbor will not count against the acquiring company as part of a recidivism analysis in future cases.

The benefits of the guidance will not accrue to the target company, which can "potentially" qualify for a declination (though only in the absence of aggravating circumstances).

The new policy will also not apply to misconduct that was otherwise required to be disclosed or already public or known to the DOJ, and it will not protect against any civil DOJ enforcement actions.

While the safe harbor announcement is certainly welcome, there are many issues that companies and defense counsel will need to carefully consider in deciding how to proceed in any given situation. Whether the adoption of the safe harbor moves the needle on companies' disclosure decisions will become clear over time.

Key takeaways

While guidance, as a general matter, can be helpful for companies to understand the DOJ's views of particular issues, this policy has questionable practical import given several significant issues.

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On the one hand, offering a safe harbor for the acquiring company, even in the presence of aggravating factors, and providing assurances that the disclosed misconduct will not be used against the acquiring company in any future recidivism analysis are tangible incentives. In that sense, this policy goes beyond the DOJ Criminal Division's Corporate Enforcement Policy, which provides for a presumption of a declination for voluntary disclosures as a general matter *absent* aggravating circumstances. It also goes much farther than the U.S. Attorney's Offices' voluntary disclosure policy, which does not provide for a presumption of a declination, but rather provides for a presumption against requiring a guilty plea, again absent aggravating circumstances.

On the other hand, there are several issues that clients and counsel should carefully consider in evaluating whether to self-disclose misconduct uncovered during M&A due diligence or post-closing integration. First, and perhaps most notably, the safe harbor under this new policy applies to the acquiring entity, not the target company. Yet after the acquisition, the acquiring entity owns the target company, and therefore will ultimately bear the costs (reputational and financial) of any resolution with the target company.

Second, there are often circumstances where the acquiring company, even with good faith robust due diligence, will not learn of the misconduct within six months, let alone be able to fully remediate it within one year. The DOJ appears aware of the practical limitations of these deadlines. In fact, DAG Monaco qualified the deadlines as "subject to a reasonableness analysis because we recognize deals differ and not every transaction is the same" and noted that the deadlines "could be extended by Department prosecutors." While these statements are helpful, the company would nevertheless have to trust the reasonableness and discretion of the DOJ prosecutors to apply the policy's benefits if the company is unable to meet the timelines.

Third, according to the DAG, "companies that detect misconduct threatening national security or involving ongoing or imminent harm can't wait for a deadline to self-disclose." This suggests that the acquiring company may not get the benefit of the safe harbor in a national security case even when it discloses within six months and remediates within one year.

Fourth, although just a passing reference in DAG Monaco's speech, it is significant that the DOJ is reserving the right to bring a civil enforcement action. Depending on the type of misconduct and whether there would otherwise be a basis for civil liability at the acquiring entity, enforcement actions can result in significant penalties. The DOJ has not yet offered any indication of what benefits would be available in this civil context (e.g., no treble damages).

Finally, if the DOJ already knows about the misconduct, for example through a whistleblower complaint, the company will not qualify for the safe harbor. Although this is consistent with DOJ's voluntary disclosure policies more broadly, it does not seem suitable in this context given that the acquiring company cannot know what is occurring at a target company until it begins the due diligence process, whereas DOJ has many other ways to learn about the misconduct at the target company. As a result, an acquiring company can do everything that the DOJ would want and expect, including identifying and reporting the misconduct as quickly as possible, and yet the DOJ will not extend the benefits of the policy because it was previously made aware of the misconduct.

Although this new guidance offers some tangible incentives for companies that voluntarily disclose misconduct uncovered during M&A due diligence, there are also significant considerations that should be evaluated before doing so. It will be critical to see how the DOJ divisions flesh out this new guidance in their respective policies and how they implement and enforce them in practice.

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