

MERGERS & ACQUISITIONS EXPORT DUE DILIGENCE: THE “MISSING PIECES”



PATTON BOGGS LLP
ATTORNEYS AT LAW

INSTITUTE FOR INTERNATIONAL AND COMPARATIVE LAW
4th Annual Program On International Corporate Compliance
Washington, DC

February 26-27, 2009

Giovanna M. Cinelli

Senior Partner and Chair,

Export Compliance & Investigations Practice Group

703-744-8075 (direct dial) gcinelli@pattonboggs.com (e-mail)



STATUS

- * Greater recognition of the need to conduct export due diligence
- * Concept incorporated into more M&A due diligence checklists
- * Company export personnel are consulted more frequently, although the timing varies
- * Deal documents include export certifications, schedules and escrows to accommodate issues or violations



AREAS OF WEAKNESS

- * Failure to understand the business being acquired or sold
- * Electronic data rooms
- * Due diligence or other checklists
- * Classifications and jurisdiction determination
- * Failure to understand technical data, “derivative technical data” and intellectual property ties beyond valuation



AREAS OF WEAKNESS

- * Failure to request and then analyze records
- * Failure to link exports with government contracts and CFIUS filings
- * Failure to “value” export authorizations properly (compared to IP licenses)



CRITICAL ISSUES

- * “User Malfunction”
- * Affects ITAR, EAR and OFAC



FAILURE TO UNDERSTAND THE BUSINESS BEING ACQUIRED OR SOLD

- * Knowledge of the business is sometimes “diffuse”
- * Perceptions vary depending upon whom you ask
- * Records scattered and not readily available
- * Failure to understand that certain *business* records are directly relevant to export issues
- * “Preparation” to sell a business
- * Consideration of business segments or assets that may remain tied to securing business from an export perspective



ELECTRONIC DATA ROOMS

- * Days of “hard copy” document rooms are dwindling or gone
- * Who has access
- * Accountability and sharing of passwords
- * “Indiscriminate” postings
- * Failure to review materials in detail prior to uploading
- * Copies from the data rooms
- * Licensing of access to the data rooms
- * Consideration of AECA, 22 USCA § 2778(g)(6)



FAILURE TO REQUEST AND UNDERSTAND RECORDS

- * Tied to problems with Checklists
- * Broad categories requested
 - ◆ “all” documents related to authorizations to conduct business
 - ◆ “all” export licenses or authorizations
- * Narrow requests
 - ◆ copy of the current registration
 - ◆ copies of current licenses
- * Reviewer or attorney analyzing materials lacks a detailed understanding of the export laws [“user malfunction”]



CLASSIFICATIONS AND JURISDICTIONAL DETERMINATIONS

- * Narrowly defined when requested
- * Sometimes provided
 - ◆ inconsistent follow-up if not provided
 - ◆ incomplete submissions or documentation
- * Sometimes posted in electronic data rooms
- * Not correlated to company or asset intellectual property rights or licenses
- * Not reviewed historically – “fruit of the poisonous tree” concept



CLASSIFICATIONS AND JURISDICTIONAL DETERMINATIONS

- * Not independently reviewed/verified
- * Not separately recognized in deal documents as requiring distinct requirements to exercise “reasonable efforts to cooperate” post-closing
- * Not separately allocated as a representation with distinct requirements, including escrow, schedules and liability – consider the impact of successor liability



CHECKLISTS

- * Too broad
- * Not tailored in the export area
- * Only a starting point but too often used as the end point
- * “Deal exigencies” – keep it secret and get it done!
- * Not reverified or revised once due diligence begins



CHECKLISTS

- * Failure to identify critical areas:
 - ◆ technical data in terms of export, government contracts, IP, and development
 - ◆ derivative technical data suffers the same problems as technical data
 - ◆ registration with DDTC
 - * Lapses
 - * Categories
 - * Updates
 - * License validity
- * “User Malfunction” –checklists by those not best suited to “reasonably and justifiably” meet export legal requirements to satisfy the deal conditions



AREAS OF WEAKNESS

- * Poorly or incompletely drafted agreements or purchase documents
 - ◆ inadequate schedules
 - ◆ inadequate transfer language
 - ◆ inadequate indemnification language
 - ◆ inadequate escrow accounts
 - * tie-back to schedules
 - * tie-back to breach provisions



WHAT TRENDS APPEAR FROM ENFORCEMENT/CONSENT CASES

* Acquisition Cases at State:

- ◆ General Motors/General Dynamics
- ◆ MultiGen/Computer Associates
- ◆ L-3/Goodrich
- ◆ L-3/Titan
- ◆ Qioptiq/Thales
- ◆ Hughes/Boeing
- ◆ EDO/Condor
- ◆ Agilent/SAFCO Technologies



“WALK-AWAY” CALCULATIONS

- * When purchasing party makes demands that reflect a *complete* lack of understanding of export laws
- * Belief in a “compliance program” – e.g., General Motors case where inquiry revealed GM had a compliance program
- * Valuation of authorizations to conduct business: licenses are now captured, but who calculates exemption and exception valuation
- * Being asked to include a condition precedent to closing that does not comport with the ITAR or EAR



QUESTIONS?