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BLOG

New DOJ Safe-Harbor Policy Incentivizes M&A Due Diligence on Government Contractors

NOVEMBER 1, 2023

In analyzing a government contractor target for a proposed acquisition—such as a merger, asset sale, or stock purchase—due diligence may uncover a seller's noncompliance with certain Federal Acquisition Regulations or other applicable regulations. Such noncompliance is important for the buyer to identify and assess for any impact on the business revenue going forward, as well as any potential financial penalties that could be imposed (e.g. those under the Civil False Claims Act). In most cases, the transactional parties are able to address these issues internally once they are identified. Although it is rare, due diligence can also reveal potential criminal violations, such as procurement fraud, bribery, kickbacks, or conspiracy charges that could result in the indictment of company officers and directors, the entity itself, and even government officials involved in the scheme.

Effective due diligence allows buyers to unearth misconduct and compliance risks prior to closing an acquisition and take appropriate steps to insulate themselves from the potential complications and liability that could arise after closing. The Department of Justice (DOJ) has recently buttressed the value of effective due diligence by announcing a new Mergers & Acquisitions Safe Harbor Policy, which is expressly designed to "incentivize the acquiring company to timely disclose misconduct uncovered during the M&A process."

Specifically, the new DOJ policy provides the following parameters for a buyer's voluntary self-disclosure to be eligible for the safe harbor for any misconduct discovered *either pre- or post-closing*:

- Disclose misconduct discovered within six (6) months from the date of closing; and
- Remediate the misconduct within one (1) year from the date of closing, which may also include restitution and disgorgement.

These safe-harbor provisions will only apply to criminal conduct discovered in bona fide, arm's-length M&A transactions. Additionally, certain exceptions to these deadlines may be imposed by the DOJ. For example, if the buyer believes the disclosure involves issues of national security or ongoing or imminent harm, these exceptions clarify that the buyer should not wait to disclose them and take remedial steps.

If the disclosing entity meets the disclosing requirements referenced above, it will "receive the presumption of a declination of prosecution" from the DOJ. In addition, a disclosure by the acquiring entity also may protect the target entity, so long as "aggravating factors" are not present. Such aggravating factors, as set forth in the DOJ's standard

Voluntary Self-Disclosure Policy (VSD) include misconduct that: (1) poses a grave threat to national security, public health, or the environment; (2) is deeply pervasive throughout the company; or (3) involves current executive management of the company. In a departure from the DOJ's standard VSD, however, the presence of these aggravating factors in the target company *will not* affect the acquiring entity's ability to obtain a declination of prosecution under the new M&A Safe Harbor Policy.

By instituting this new policy, the DOJ is encouraging companies to voluntarily self-disclose misconduct uncovered through M&A due diligence by incentivizing buyers with protection from liability for misconduct discovered, not only during due diligence, but in the six months following the close of a transaction.

In conclusion, buyers that engage outside counsel to conduct specialized due diligence of government contractor targets may be able to identify and act on non-compliance and other issues that fall within the DOJ M&A safe harbor provision. Through this new policy, buyers may be able to protect themselves against future criminal liability for actions taken by a target if the due diligence uncovers, and the acquiror timely reports, misconduct, including violations of the Criminal False Claims Act (18 U.S.C. § 287), the Anti-Kickback Act of 1986 (41 U.S.C. § 51), and other federal offenses of fraud, bribery, bid rigging, and conspiracy to commit these acts.

Please contact the authors or your Winston & Strawn relationship attorney if you have any questions or need further information.

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