THE M&A MAZE: DUE DILIGENCE AND INTERNATIONAL TRADE LAW

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In our increasingly global economy, mergers and acquisitions must frequently be considered in an international context. Due diligence investigations must often be conducted in two or more countries. In addition to local law requirements relating to assets acquired, competition law and securities law implications are routinely addressed.

The effect of international trade law on the combined business is often overlooked in such transactions. This body of law includes customs laws, trade remedies, sanctions and anti-corruption laws. The failure to conduct due diligence investigations with respect to these issues may lead to a Trojan Horse of a deal, with nasty surprises ranging from significant fines and duties to the loss of access to markets for customers, or loss of inputs into the production process. Breaches of rules relating to sanctions and anti-corruption laws may also result in criminal prosecution of officers and directors of offending companies.

Potential liability can be enormous, particularly due to provisions allowing for retroactive assessment of duties, tariffs and penalties. Many acquisition agreements incorporate indemnification clauses, but these may offer limited protection. Retroactive assessments may occur several years after closing of a transaction, which may prevent redress if the assets of the vendor are no longer accessible. Patterns of conduct established prior to an acquisition may continue and subsequently lead to liabilities that may no longer be amenable to indemnification. The safest course is a comprehensive due diligence exercise that addresses international trade issues.

Some questions that should be asked in any mergers and acquisitions process include:

- Is there a Customs compliance program in place with an orderly record-keeping system to protect against substantial tariff assessments and penalty duties with respect to customs issues? Day-to-day routine customs issues such as tariff classification, value for duty and rules of origin can result in significant retroactive duty assessments. Accuracy of record keeping is accordingly a critical concern.
- Are there any current or pending anti-dumping proceedings that might affect the export or import of goods produced or sold by the merged entity? Any anti-dumping orders in force in an important market

may result in a substantial impairment in the ability of a producer to continue to do business. A business may be affected directly through barriers to the export of goods, or through restrictions on the ability to import production inputs.
- Is production subsidized in one of the countries, or are one of the producing companies relying on subsidized inputs? The imposition of countervailing duties may, like anti-dumping laws, significantly impede the ability of a company to do business in a country where such a countervail order is being enforced, either through restrictions on export sales limits or access to imported production inputs.
- Are there safeguard remedies in place? Safeguard actions are another form of trade remedy that may result in the imposition of quotas or tariffs on imported goods. These in turn may seriously impede the ability of a company to do business.
- Is the business being acquired enjoying the benefits of trade protection? The enforcement of a particular trade remedy may result in a business showing revenues and profits that are not sustainable without that protection.
- Does the target company sell to or purchase inputs from a country subject to trade sanctions? Multijurisdictional businesses may be faced with different rules in different countries, and the scope of sanctions in each country in which business is conducted should be canvassed.
- Does the target company have an anti-corruption compliance plan. The existence of a stated policy can mitigate liability for inappropriate actions of employees. The absence of such a plan may leave a company more susceptible to criminal prosecution.

Some major concerns in the Canadian context include the following:

- Tariff classifications may be redetermined by the Canada Border Services Agency ("CBSA"). The rule is "you pay, then you appeal." The Customs Act allows the CBSA to retroactively reclassify goods for up to four years in the normal course, or for an unlimited time in certain circumstances.
- Rules of origin will determine whether goods are entitled to preferential tariff treatment (such as NAFTA). The CBSA routinely conducts rules of origin audits to verify the right to preferential tariffs. If information is not available to confirm the conditions to qualify for the preferential tariff, the CBSA may retroactively assess duties up to four years in the normal course, and for an unlimited period in certain circumstances.
- Errors in reported value for duty may lead to substantial increases in customs duties; one particular issue of note is that related companies may required to correct customs documentation to reflect internal amendments to transfer pricing after importation of goods.
- Even shoddy preparation of Customs documentation may give rise to significant liability. Under the Administrative Monetary Penalty System ("AMPS"), the CBSA may impose fines of up to $25,000 on every entry of goods. These fines may be imposed even if the misreporting of shipments would not otherwise

give rise to additional duty liability. There is no express limitation on retroactive assessments of AMPS fines.

- In anti-dumping and countervailing duty proceedings, the CBSA does not normally review subject entries on a case-by-case basis, but rather, reviews all entries periodically. Where specific arrangements between an exporter and the CBSA have not been made, the CBSA routinely will assess "penalty" rates of anti-dumping duties that are often in excess of 50%. It is the importer who must pay these duties. Under the Special Import Measures Act, the CBSA may redetermine anti-dumping or countervailing duties retroactively for up to two years in the normal course, or for an unlimited period in the event of misrepresentation or fraud.
- In the case of global safeguard actions there is no retroactive application of duties; however, one must be aware of the nature of remedies applied. For example, if a tariff rate quota is imposed on a "first past the post" basis, shipments may be subject to a substantial surtax if they enter the country after quota has been filled.
- Sanctions under the Special Economic Measures Act can range from an outright ban on trade (such as with North Korea) to restrictions on doing business in particular fields or with specified individuals (such as with Russia).
- Canada's *The Corruption of Foreign Public Officials Act* establishes an extra-territorial reach of Canadian law to corrupt practices of Canadian companies wherever the conduct takes place. In addition to substantial fines, directors may face up to 14 years in prison.

While these examples are taken from Canadian law, most of these issues arise in countries around the world. Failure to consider these aspects of international trade rules can have a devastating impact on the value of a business and may also result in substantial fines, penalties, and even criminal prosecution. Notwithstanding the potential damage, an analysis of the impact of international trading rules is still not a common component of the due diligence process. Given the substantial retroactive liabilities possible under customs law, the power of trade remedies law to terminate the ability of a company to do business across borders or to obtain key production inputs, and the potential liabilities arising from sanctions and anti-corruption laws, we would suggest a global economy requires global due diligence on international trade issues.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.