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OPED: MITIGATING MONEY TRANSFER FRAUD IN M&A

Latham & Watkins' Bret Stancil and Bridge Bank's Heather Kelly discuss the steps dealmakers can take to ensure that merger consideration is delivered to payees in an age of widespread fraud risk.

BY DEAL CONTRIBUTORS

The following article was submitted by Bret Stancil, an M&A partner at Latham & Watkins LLP in Silicon Valley, and Heather Kelly, chief strategist, managing director and senior relationship manager for the Business Escrow Services Group at Bridge Bank, a division of Western Alliance Bank, Member FDIC.

Latham's Bret Stancil and Bridge Bank's Heather Kelly

In April 2022, a Delaware Court of Chancery opinion established that buyers may ultimately be responsible for ensuring merger consideration reaches security holders, even in circumstances where a buyer uses a third-party vendor to facilitate payments. The decision, coupled with a recent uptick in fraud, highlights the importance of heightened sensitivity to money transfer risks in M&A transactions and a comprehensive approach to mitigate the threat.

The risks are significant: Internet fraud resulted in losses of $6.9 billion in 2021, according to the FBI's Internet Cyber Crime Center, with nearly $2.4 billion due to business email compromise. They are also particularly relevant during a significant liquidity event such as an M&A transaction. The sums of cash involved, the often hectic pace of the days leading up to closing and the number of parties involved make the M&A transaction a particularly attractive target for bad actors.

As each party can help mitigate fraud risk in M&A transactions, it's important for all participants in a deal to understand the most vulnerable steps of the process, signals to look out for and the safeguards that can be put in place to deter would-be offenders.

To explore the topic, Latham & Watkins' Bret Stancil and Bridge Bank's Heather Kelly sat down to discuss it.

The Deal: What should buyers and sellers expect of deal vendors engaged to disburse deal proceeds?

Heather Kelly: An agent should be clear and consultative in its approach. This includes understanding the dynamics, the parties involved and even the composition of the cap table to advise on the best and safest

methods of communication. Clients should have a good understanding of what security measures the agent has in place. Agents need to secure as many entry points as possible — whether that be encrypting emails for parties to send in records, having a secure online portal for security holders to submit payment and tax information, or evolving new and enhanced features that eliminate a bad actor's access to the process.

It is also crucial to question handoffs. Banks or nonbanks that don't offer all services in-house create additional potential entry points for a bad actor. For example, when companies that aren't a bank facilitate payments, they may have many handoffs with the bank that controls money movement, or they may use white-label payment services. Both practices may inadvertently create opportunities for fraudsters.

How should parties lean on legal counsel to protect their interests and assets against fraud?

Bret Stancil: It is crucial that counsel be hyper-vigilant in recognizing the potential for fraud throughout the deal. A threat campaign may start quietly weeks before wire instructions are solicited. Counsel should consider it part of their job to be alert regarding opportunities for fraud.

Practically speaking, counsel can promote that vigilance by adopting technology designed to flag potentially suspicious activity and/or block the entry point for such activity altogether — including technology designed to identify spoofed domain names and suspicious emails and secure file transfer systems that can be used in lieu of email when transmitting sensitive information.

Counsel should also seek to adopt processes that minimize opportunities for bad actors. M&A deal teams often include dozens of lawyers, advisers and agents. By limiting the number of deal team members who access or "hold the pen" on particularly sensitive information, such as funds flow documents, counsel can limit opportunities for fraud by cutting down on the number of times sensitive information is shared and the number of persons making keystrokes in a deal's most sensitive documents. By implementing strict procedures for updating and revising sensitive information, legal counsel can ensure that the frenzy of closing does not give rise to an opportunity for fraud.

What role do clients play in protecting themselves during a merger or acquisition?

Kelly: Clients should vet their agents to ensure this work is done by a secure financial institution required to comply with information security and privacy regulations mandated of publicly traded banks. It's essential to look for a solid track record of experience in those administrating the transaction and ensure that the agent understands and complies with the benchmark of the Securities Transfer Association rules and guidelines. These rules are industry best practices designed to protect the process and, at the end of the day, clients.

How might parties to an M&A transaction vet the security policies and practices of prospective deal vendors and legal counsel?

Stancil: It is important that parties to an M&A transaction be selective in partnering with trusted vendors. That means choosing a vendor that both "talks the talk" and "walks the walk" — parties should select deal vendors that recognize the potential for fraud and proactively offer products and processes designed to mitigate the same.

Parties to an M&A transaction often look to counsel to recommend the right vendor for a transaction, and many vendors will interact exclusively with counsel throughout a deal. Counsel should encourage clients to select vendors that prioritize security and should encourage vendors to consider themselves full-fledged members of the deal team, with full authority to escalate issues to the highest level and to hold up the process if there are issues or concerns.

Kelly: At the end of the day, as we've seen from recent case law, the courts have ruled that it may ultimately be the purchaser's obligation to ensure that deal consideration makes it into the hands of the security holder recipients. These are scary times, and to minimize their exposure, purchasers need to surround themselves with vigilant partners to ensure they are protected in their obligations under the definitive agreement.

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