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FCPA Best Practices: Due Diligence in International M&A

Both the U.S. Department of Justice (DOJ) and the SEC have been aggressively asserting claims (generally based on theories of successor liability) against purchasing corporations for pre-merger conduct of the target that violated the FCPA.

The agencies' recent issuance of "A Resource Guide to the U.S. Foreign Corrupt Practices Act" (Guidance) makes clear that the U.S. government will continue to actively investigate and prosecute companies for pre-merger conduct of targets that violate the FCPA.

It is imperative that an acquirer conduct FCPA-specific due diligence of a target, particularly if the target has a high FCPA risk profile. The enforcement agencies have made it clear that they consider such due diligence to be essential not only where the target company was previously subject to the FCPA, but also in situations where the target, by virtue of the transaction, is for the first time becoming subject to the FCPA. In the view of the agencies, FCPA liability begins the moment that the purchase transaction is completed.

As explained below, FCPA compliance in the mergers and acquisitions context is not something that can be dealt with just by drafting an allocation of the risk through representation and warranty provisions. The risks of such an approach include failing to identify unacceptable risks of potential FCPA violations that would make an acquisition uneconomical, overpayment for an acquisition, and failure to identify FCPA issues that will require immediate attention post-closing. In light of these possibilities, acquirers need to implement active steps both before and after a merger or acquisition occurs.

DOJ AND SEC GUIDANCE

The Guidance, released on November 14, 2012, is non-binding and intended to be an informal summary of the current state of the law based on FCPA enforcement actions and FCPA Opinion Procedure Releases. While many practitioners were hoping for clearly stated, bright-line rules, which the Guidance does not provide, the Guidance does provide a helpful summary of the agencies' views regarding prudent compliance practices.

FOR MORE INFORMATION

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The Guidance specifically addresses successor liability in the context of mergers and acquisitions. It notes that companies generally acquire a host of liabilities when they merge with or acquire another company, and that FCPA violations are no exception. Given the large number of compliance actions that have included companies involved in merger and acquisition activities, it is not surprising that the agencies would choose to highlight this area. The DOJ and SEC encourage companies to conduct pre-acquisition due diligence and to improve compliance programs after acquisitions for a number of reasons:

- Pre-acquisition due diligence helps acquiring companies accurately value target companies

- Due diligence reduces the risk of a company unknowingly continuing to pay bribes post-acquisition
- The consequences of potential violations uncovered during pre-acquisition due diligence can be handled by the parties in an orderly and efficient manner through negotiation of the costs and responsibilities for the investigation and remediation
- Due diligence is evidence of a genuine commitment to FCPA compliance

The agencies note that in the merger and acquisition context, where companies have voluntarily disclosed and remediated FCPA-violative conduct, the DOJ and SEC have, in a significant number of instances, declined to take action against companies. While this statement is not binding, it is instructive. According to the Guidance, enforcement agencies have only taken action against successor companies in limited circumstances, generally in egregious cases or where the successor company failed to stop the misconduct post-acquisition. More often, the DOJ and SEC pursue actions against only the predecessor company (if subject to the FCPA pre-merger), particularly when the acquiring company uncovered and timely remedied violations or when the government's investigation of the predecessor preceded the acquisition.

The enforcement agencies place a heavy emphasis on the importance of conducting adequate due diligence, voluntarily disclosing violations, and integrating and implementing an effective compliance program to minimize the potential for incurring successor liability.

BEST PRACTICES: DUE DILIGENCE

Although the agencies have not provided any bright-line rules to indicate what defines adequate FCPA due diligence, below are some best practices that companies should consider regarding due diligence in the mergers and acquisitions context.

EARLY TARGET EVALUATION

- Consider a target's FCPA risk profile early. Items to consider include the manner in which the company does business, its industry, and whether that industry is the subject of recent enforcement activity.
- Assess the risk of the markets where the target does business. Does the target do business in Brazil, Russia, India, China, Africa, the Middle East, or in high-risk countries that have generated FCPA enforcement actions in the past or rate poorly in the Transparency International Corruption Perception Index?
- Assess the risk of the target's industry. Is the industry one with foreign government customers, heavy government regulation, or substantial government contact?
- What is the reputation of the target regarding bribery, corruption, or other criminal or unethical conduct?

To learn this information, the acquirer should require prospective targets to complete a detailed FCPA questionnaire at the beginning of the process. An acquirer can also engage a reputable law firm or investigative firm and/or consult with the U.S. Department of Commerce, the U.S. Department of State, or the relevant U.S. embassy to learn more about the target. This information is best analyzed by an experienced FCPA practitioner knowledgeable about the FCPA and the current state of FCPA enforcement.

DUE DILIGENCE PLAN

If an acquirer determines that it will move forward with a target with potential FCPA risk, the acquirer should prepare a comprehensive FCPA due diligence work plan focused on the target's specific risk profile. This includes more than a mere review of the target's financial statements (though that is, of course, necessary). Due diligence should also include a review of the following:

- The ownership structure of the target, including whether any individual who may be deemed a foreign official owns or is involved in the operation of the business
- The target's relationships with, and reliance on, third parties, including agents, consultants, brokers, joint-venture partners, distributors, and so forth
- The target's dealings with any foreign government agencies or commercial dealings with state-owned or state-controlled customers
- The target's tax, customs, and immigration matters and its government licenses, permits, and certifications, and its procedures for dealing with these issues
- The target's political activities, community development programs, and charitable activities
- The target's anti-corruption compliance program, with a focus on how it is implemented, monitored, and audited, including details on reported potential violations and information on the current status/disposition of any such matters
- The target's policies regarding entertainment of government officials, including a report of all such expenses and the officials involved
- An accounting of all payments made to reimburse government officials for any reason, including visits to conferences or elsewhere
- Any suspected violations of the FCPA or other anti-bribery laws that have been investigated by the target, and any investigation results
- Any inquiries from any government regarding potential bribes, whether current or settled
- The target's financial and accounting records, including a detailed analysis of third-party expenses such as commissions and travel, entertainment, and marketing expenses
- Any concerns raised by an audit of the company books or inquiry by the government into the accuracy of the company's books and records or the adequacy of the target's internal controls
- The target's financial and accounting controls
- Any FCPA "red flags" uncovered during the due diligence process

WHAT IF A POTENTIAL VIOLATION IS UNCOVERED?

A potential violation does not have to kill a deal. There may well be instances where the FCPA risk is sufficiently high that the transaction makes no sense, but not always. In those circumstances where FCPA red flags are identified, but the company still wants to consider proceeding with the deal, an acquirer should take certain additional measures to limit its exposure. Additional investigation is usually necessary — it will be important to delve further into the "red flags" to understand the context and to determine whether the conduct at issue would constitute a violation. Sometimes it would, but sometimes not. In addition, there may be circumstances where additional or different certifications or representations and warranties are necessary.

In those instances where the acquirer determines that the target has in fact engaged in conduct violative of the FCPA — and still wishes to proceed with the deal — there are steps the acquirer can take to minimize its exposure. These steps include:

- Issuing instructions to the target's affected affiliates and employees to cease all illicit payments or other questionable conduct and taking steps to ensure that the conduct has indeed ceased
- Requiring the target to disclose the conduct at issue to the DOJ/SEC and to the public

- Requiring the target to suspend or terminate the officers and employees implicated in the potentially violative conduct, pending the results of an internal investigation
- Implementing a comprehensive FCPA training program (or supplementing an existing training program) for target employees post-acquisition

The Guidance makes it clear that the DOJ and SEC are likely to look favorably on acquiring companies that:

- Continue to cooperate with the DOJ, SEC, and foreign law enforcement authorities with respect to any remaining issues
- Appropriately discipline any employees or officers of the target found to have made or authorized illicit payments, including cutting all ties to employees, agents, or other actors associated with the FCPA violations
- Disclose to enforcement agencies any additional pre-acquisition payments to foreign officials made by the target or its subsidiaries that are discovered after the completion of the acquisition
- Extend to the target the acquirer's existing FCPA compliance program, and modify the program as appropriate, to ensure that it is reasonably designed to detect and deter violations of the FCPA and foreign anti-corruption laws

DEAL DOCUMENTS

As noted above, FCPA exposure cannot be eliminated through the use of representations and warranties and an allocation of risk in deal documents. That does not, however, mean that these documents are not important. As part of any deal involving merging or acquiring a target where FCPA liability is even a potential issue, companies must be sure to include representations, warranties, and indemnifications in their deal documents.

These representations and warranties should cover, amongst other things, the following:

- That the target, and any of its owners, employees, affiliates, agents, or representatives have not violated the FCPA
- That the target, and any of its owners, employees, affiliates, agents, or representatives will not violate the FCPA
- That no foreign government official or relative of a foreign government official has an ownership interest in the target
- That the target has received and reviewed a copy of the FCPA and understands its terms
- That the target (to the extent it still exists after the merger or acquisition) shall indemnify the acquirer against any liabilities, losses, and expenses, including any civil or criminal fines, that the acquirer may incur as a result of any violations of the FCPA by the target
- That the acquirer may cancel the merger or acquisition without any penalties should a violation of the FCPA be uncovered prior to the execution of the merger or acquisition