

Conducting Pre-Acquisition FCPA Due Diligence

There are several recent examples where companies, bought both businesses and there pre-existing violations of the Foreign Corrupt Practices Act (FCPA), in large part because the acquiring companies failed to perform sufficient FCPA due diligence in the overall pre-acquisition due diligence. These examples include the Alliance One matter resolved this past summer with a \$4.2 million fine for pre-acquisition conduct and \$10 million in profit disgorgement. There was also the \$240 million fine levied against Saipem for conduct of an acquired subsidiary of ENI, Snamprogetti, where the conduct at issue occurred over 2 years prior to the acquisition. One of the strongest examples is that of eLandia International Inc., which acquired Latin Node Inc., in 2007. Thereafter, it discovered potential FCPA violations, which it self-reported to the DOJ. As reported in the FCPA Blog, in addition to a \$2 million fine, eLandia also disclosed that its purchase price for Latin Node "was approximately \$20.6 million in excess of the fair value of the net assets" mostly due to the cost of the FCPA investigation, the resulting fines and penalties to which it may be subject, the termination of Latin Node's senior management and the resultant loss of business. eLandia eventually wrote off the entire investment by placing Latin Node into bankruptcy and shuttering the acquisition.

There are several steps that a company should take when performing pre-acquisition FCPA due diligence. Yesterday at the Hanson Wade FCPA conference in Houston, some of these steps were discussed. While these steps are not an exhaustive list, they do provide a company with some guidance on specific issues to investigate to protect themselves from buying not only a new company but a FCPA enforcement action. These steps include:

1. **Charity Begins at Home.** Review high risk geographic areas where your company and the target do business. If there is overlap, seek out your own sales and operational people and ask them what compliance issues are prevalent in those geographic areas. If there are compliance issues that your company faces, then the target probably faces them as well.
2. **Get Sales Lists.** Obtain from the target a detailed list of sales going back 3-5 years, broken out by country. If you can obtain a further breakdown by product or services get that as well. You do not need to investigate *de minimis* sales amounts but focus your FCPA due diligence inquiry on high sales volumes in high risk countries.
3. **Get List of Foreign Business Representatives.** If the target uses a sales model of third parties, obtain a complete list, including JVs. It should be broken out by country and amount of commission paid. Review all underlying due diligence on these foreign business representatives, their contracts and how they were managed after the contract was executed. But your focus should be on large commissions in high risk countries.
4. **Talk.** You will need to speak to the target company personnel who are responsible for its compliance program to garner a full understanding of how they view their compliance program.

5. **T&E Records.** You will to review the travel and entertainment records of the target's top sales personnel in high risk countries. You should retain a forensic auditing firm to assist you with this effort. Use the resources of your own company personnel to find out what is reasonable for travel and entertainment in the same high risk countries which your company does business.
6. **Disclosure.** While always an issue fraught with numerous considerations, there may be others in the M&A context such as any statutory obligations to disclose violations of any anti-bribery or anti-corruption laws in the jurisdiction(s) in question; what effect will disclosure have on the target's value or the purchase price that your company is willing to offer.
7. **Compliance Convergence.** While you are performing the FCPA due diligence, you should also review issues for anti-money laundering and export control issues.

While not discussed in the presentation, we also believe that after the due diligence is completed, and if the transaction moves forward, the acquiring company should attempt to protect itself through the most robust contract provisions that it can obtain, these would include indemnification against possible FCPA violations, including both payment of all investigative costs and any assessed penalties. An acquiring company should also include reps and warranties that the entire target company uses for participation in transactions as permitted under local law; there is an absence of government owners in company; and that the target company has made no corrupt payments to foreign officials. Lastly, there must be a rep that all the books and records presented to the acquiring company for review were complete and accurate.

The clear trend in FCPA enforcement is an increased and aggressive level of enforcement activity under the both the DOJ and Securities and Exchange Commission. Businesses must be particularly heedful in the engaging in the mergers and acquisitions process, whether acquiring other companies or being acquired. Due diligence in these situations is critical and must encompass the full range of FCPA compliance issues.

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