Chadbourne's Quarterly FCPA Report - The importance of pre-acquisition due diligence

There are several law firms which put out annual, semi-annual and quarterly reports on the Foreign Corrupt Practices Act (FCPA). One recent report is the Compliance Quarterly, Spring 2012 Report by Chadbourne & Parke LLP. Rather than compiling a list of cases with highlights and lessons learned for the compliance practitioner, Chadbourne focuses on one, or a few issues, with some depth. The spring report continues this trend with an article entitled "*Are You Paying Too Much? How Smart Companies Use FCPA and UK Bribery Act Due Diligence to Ensure their Deals are Valued Correctly*" by Scott Peeler.

The article begins with a review of the FCPA and Bribery Act and then moves into some of the costs for a FCPA investigation. The costs can include a drop in stock value after the announcement of an ongoing investigation; the cost of the internal investigation, including both legal and forensic accounting costs, and the tremendous amounts which companies have been fined. Further, if a company bases its deal value on sales which have been obtained through bribery and corruption the actual value of the company may be far less than paid for by an acquirer.

The report suggests that to avoid a loss in an acquisition's value, an acquiring company must conduct careful anti-corruption due diligence that is specifically tailored to the company being acquired. Peeler urges that the level of risk should be assessed through a series of key questions, which he sets forth.

1. Are any employees, owners, or principals current or former government employees or closely affiliated with one?
2. What practices and safeguards are there regarding gifts, entertainment, hospitalities, charitable contributions, sponsorships, donations and other benefits?
3. What is the target's relationship with intermediaries (distributors, agents, consultants, etc.)?
4. Have there been any past investigations/violations?
5. Does the target operate in a high-risk industry/high-risk country?
6. What is the target's association with foreign governments? Does it provide them with goods and services? Is it government owned or controlled? Does it rely on government-issued licenses or permits?
7. Does the target have clear policies and procedures in place to detect; report and manage FCPA and UK Bribery Act violations?
8. Is there any suspicion of FCPA or UK Bribery Act violations in the target?
9. What does the Transparency International Corruption Perception Index reveal about the target?

Peeler also suggests that a target company's internal controls and books and records should be evaluated in the following areas:

1. Use of agents and outside consultants;
2. Expense claims, payments and petty cash disbursements;
3. Contracting/contact points with government bodies;
4. Fraud response procedures/mechanisms;
5. Entertainment and gift practices;
6. Record-keeping practices and accuracy of books and records; and
7. Relationships with state-owned enterprises.

In a suggestion that is clear cutting edge *best practices*, Peeler recommends that in order to reduce the risk of potential FCPA and UK Bribery Act liability, an acquiring entity should consider (1) encouraging the target to undertake an internal compliance investigation prior to any potential investment; (2) insisting on the right to audit the books and records of the target; (3) insisting on anticorruption and compliance representations and warranties; and (4) requiring execution of FCPA and UK Bribery Act compliance certifications. Further, if the due diligence reveals FCPA or UK Bribery Act issues Peeler notes that a buyer has several options available, including (a) negotiating specific indemnification provisions; (b) self-reporting to the Department of Justice (DOJ) or Securities and Exchange Commission (SEC); (c) adjusting the deal price or walking away from the transaction; and (d) allocating potential fees and fines in the merger agreement.

The one thought that Peeler concluded the Report with struck me the most. It was that while corruption is expensive and it can certainly kill a deal, “Smart companies, however, turn those negatives to their advantage.” By engaging in an appropriate level of pre-acquisition due diligence a company can not only protect themselves from potential legal exposure but also get the closest and most accurate value for an acquisition. But most importantly, from my perspective, is that you know who and what you are acquiring. If an acquired company had a propensity for bribery and corruption, simply because you acquired them is probably not going to change that culture. That is the most important piece of intelligence that you can obtain from pre-acquisition due diligence.

This publication contains general information only and is based on the experiences and research of the author. The author is not, by means of this publication, rendering business, legal advice, or other professional advice or services. This publication is not a substitute for such legal advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified legal advisor. The author, his affiliates, and related entities shall not be responsible for any loss sustained by any person or entity that relies on this publication. The Author gives his permission to link, post, distribute, or reference this article for any lawful purpose, provided attribution is made to the author. The author can be reached at tfox@tfoxlaw.com.

© Thomas R. Fox, 2012