Private Equity and the FCPA

In a Wall Street Journal (WSJ) article on December 22, 2010 by Joe Palazzolo, he reported that the Securities and Exchange Commission (SEC) is investigating Europe's largest insurer, Allianz SE, for possible bribery by a German printing press company in which it holds majority stake. Palazzolo opined that this probe could break new ground in US enforcement of the Foreign Corrupt Practices Act (FCPA). The SEC has never charged a private equity firm based on the conduct of a foreign private company in its portfolio. As we enter 2011, one of the things that the FCPA compliance community has learned from the prior year is that the Department of Justice (DOJ) and SEC have announced they will review the conduct of certain industries to determine if they are in compliance with the FCPA. In late 2009, the DOJ made a very public display of announcing it had targeted the pharmaceutical industry and in January, 2010, they arrested 21 individuals in the US armament industry in the largest ever FCPA undercover sting operation, the Gun Sting investigation.

However, this initial enforcement effort in the private equity arena could be one which grows during this year. In an article in the New York Times Dealb%k, on December 22, 2010, entitled, "*Private Equity Looks Abroad, but May Be Blind to the Risks*," reporter Steven Davidoff wrote that some recent comments by Stephen A. Schwartzman, CEO of the Blackstone Group, indicated that the US is "over-regulated and that private equity's greatest investment opportunities lie across the oceans." Davidoff indicated that this position may be "overstated" and private equity may encounter a number of problems abroad." He listed several pitfalls for such investments abroad, however one issue he did not list was the FCPA.

The SEC investigation of Allianz signals that private equity should proceed with caution because the purchase of an overseas company could lead to potential FCPA liability. The recent FCPA enforcement action against RAE Systems, Inc., drove home once again that a US company is responsible for the actions of joint venture in which it holds a majority interest. There are several other examples where companies, which acquired targets, sustained large FCPA fines for the FCPA violations the acquired companies had engaged in prior to the acquisition. These 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.

As noted by Davidoff, one of the reasons that private equity has been successful in the US "was its ability to reorganize companies by taking majority ownership and eliminating managerial inefficiencies." Unfortunately the one thing that an FCPA investigation can bring, whether brought on via internal disclosure, whistleblower or DOJ targeting certain industries, is very high costs. Additionally many companies are required to add significant compliance personnel to resolve any FCPA enforcement action. This would not seem to be the pattern for success by the private equity market. Further, if the DOJ or SEC is successful in reaching a private equity owner in the Allianz investigation, where the private equity owner is a European parent, it could well open the doors for investigation in equally high profile private equity entities in the US.