

The FCPA and Mergers and Acquisitions

In a webinar on December 2, 2010, Michael Volkov, partner in the law firm of Mayer Brown and Ryan Morgan, Sales and Alliance Director of World Compliance, discussed the implications of the Foreign Corrupt Practices Act (FCPA) to mergers and acquisition.

They advise that businesses which seek to minimize their FCPA liability risks should pay careful attention to the potential exposure created by merger and acquisition activity. This is due to the fact that unwary companies can “purchase” FCPA liabilities by failing to conduct appropriate due diligence of their intended transaction partner. On the other hand, companies alert to those risks have been able to avoid successor liability altogether or, more frequently, obtain assurance about the scope of potential FCPA liability before the transaction is complete. Indeed, successor liability may attach in a stock transfer or merger because the assets and liabilities of the target company generally transfer to the acquiring company after closing; or the liability may attach in an asset purchase depending on the extent of the purchase and whether the target business is continuing or if the purchase agreement specifies which assets and liabilities transfer.

There are several recent 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.

Volkov advocated beginning with a risk based assessment to focus the required due diligence. Such an assessment would focus on several inquires, these would include such areas as to what countries does the target company operate in and how they rank on Transparency International's Corruption Index, including the level of corruption in each country? An inquiry into the targets business is also critical, for example does the target company sell to foreign governments and does its business depend on licenses or other approvals from foreign governments? A thorough investigation should include whether relationships exist among target company personnel and government officials through family and friends, etc.

After this more general business risk assessment, the review should turn to the policies and procedures of the target company. Basic inquires such as does the target have a

FCPA compliance policy and how well does it maintain compliance records are a good starting point. Does the company have a hotline and does it conduct FCPA training? A critical inquiry is the use of third parties as foreign business representatives. Lastly is the target company or any of its competitors, suspected or under investigation for corruption and are there any other internal investigations ongoing which should be reviewed?

Volkov also noted 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. This article has provided to you a starting point for your analysis.

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