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Business partner due diligence: Selecting and managing agents, joint ventures, and consultants

By Thomas Fox

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US companies have long utilized foreign business partner relationships to leverage their global reach and assist in the growth and development of overseas business relationships. When a US company enters into this type of business relationship, it enables the company to expand their commercial reach in a cost effective manner. One key component of this foreign business relationship is that the US company must manage compliance by the foreign business partner under the Foreign Corrupt Practices Act (FCPA).

Although the FCPA itself does not speak directly to the foreign business partner's issue, the Federal Sentencing Guidelines for FCPA violations, and related US government commentary, make clear that US-based companies bear the same legal responsibility for the actions of foreign business partners as they do for the actions of their own employees. The Securities Exchange Commission (SEC) and Department of Justice (DOJ) Deputy Attorney General Paul McNulty each confirmed that the quality of a company's due diligence on foreign business partners will be considered when fashioning penalties for companies whose business partners violate the FCPA.[1,2]

In spite of these clear statements by the SEC and DOJ, the relationships of US companies with foreign business partners remains one of the greatest areas of consternation for US companies. In its "2008 Anti-Bribery and Anti-Corruption Survey," KPMG Forensic reported, based on responses from 103 US multinational company executives, that 85% of the respondents said their company has a formal FCPA or anti-corruption compliance program; however, even with this high level of commitment to the FCPA, many respondents still feel uneasy about third-party due diligence. The survey reported:

- 82% said the challenges they faced in performing effective due diligence on business partners, including foreign agents and other third parties, was "challenging";
- 76% of the companies responding said that auditing third parties for compliance was "a significant challenge";
- 73% said their mergers and acquisitions due diligence is less than adequate; and
- 27% said the level of their mergers and acquisitions due diligence is minimal.

Establishing the relationship—Due diligence, due diligence, and then, due diligence

In view of the critical risks a US company must manage when entering into a relationship with a foreign business partner, the company should, before entering into such a relationship, start the risk management process by initiating thorough due diligence on the foreign business partner. The due diligence process should contain, at a minimum, inquiries into the following areas:

- **Need for the relationship:** Articulate the business case for the relationship with the proposed foreign business partner.
- **Credentials:** List the critical reasons for selection of the proposed foreign business partner. This should include a discussion of the business partner's background and experience.
- **Ownership structure:** Describe whether the proposed foreign business partner is a government or state-owned entity, and the nature of its relationship(s) with local, regional, and governmental bodies. Are there any members of the business partner related, by blood, to governmental officials?

- **Financial qualifications:** Describe the financial stability of, and all capital to be provided by, the proposed foreign business partner. Obtain financial records, audited for 3 to 5 years, if available.
- **Personnel:** Determine whether the foreign business partner will be providing personnel, particularly whether any of the employees are government officials. Obtain the names and titles of those who will provide services to the US company.
- **Physical facilities:** Describe what physical facilities will be provided by the foreign business partner. Who will provide the necessary capital for their upkeep?
- **Reputation:** Describe the business reputation of the proposed foreign business partner in its geographic and industry-sector markets.

These due diligence inquiries are required under the Federal Sentencing Guidelines, the guidance offered by DOJ Opinion Releases, and the publicly released Plea Agreements and Deferred Prosecution Agreements (DPA) entered into by US companies that admit to violating the FCPA. This due diligence should be recorded and maintained by the US-based company for review, if required, by a governmental agency.

After this initial inquiry is concluded the US company should move forward to perform a background check on a prospective foreign business partner by using the following resources:

- **References:** Obtain and contact a list of business references.
- **Embassy check:** Obtain information regarding the intended business partner from the local US Embassy, including an International Company Profile Report.
- **Compliance verification:** Determine if the foreign business partner, and those persons within the foreign business partner who will be providing services to the US company, have reviewed or received training on the FCPA.
- **Foreign country check:** Have an independent third party, such as a law firm, investigate the business partner in its home country to determine compliance with its home country's laws, licensing requirements, and regulations.
- **Cooperation and attitude:** One of the most important inquiries is not simply a legal issue, and might be more of an 'attitude' issue, because it is based upon the response and cooperation of the foreign business partner. Did the business partner object to any portion of the due diligence process? Did it object to the scope, coverage, or purpose of the FCPA? In short, is the business partner a person or entity that the US company is willing to stand up with under the FCPA?

After a company completes these due diligence steps, there should be a thorough review by the board, or other dedicated management committee, on the qualifications of the proposed foreign business partner. It is critical that the reviewing committee is not subordinate to the US company's business unit that is responsible for the business transactions with the foreign business partner. This review should examine the adequacy of due diligence performed in connection with the selection of overseas partners, as well as the foreign business partner's selection of agents, subcontractors, and consultants who will be used for business development on behalf of the US company.

Formalizing the relationship—Compliance, compliance, and then, compliance

After completing the due diligence review, the committee should conduct a review of the proposed contract with the foreign business partner. The contract must have compliance obligations stated in the formation documents, whether it is a simple agency or consulting agreement or a joint venture with several formation documents. All formation agreements should include representations that in all undertakings the foreign business partner will make no payments of money or anything of value, nor will such be offered, promised, or paid, directly or indirectly, to any foreign officials, political parties, party officials, or candidates for public or political party office to influence the acts of such officials, political parties, party officials, or candidates in their official capacity, to induce them to use their influence with a government to obtain or retain business or gain an improper advantage in connection with any business venture or contract in which the company is a participant. There must also be periodic re-certifications confirming that there have been no actions which violate any of these obligations.

Additional key elements of a contract between a US company and a foreign business partner include the retention of audit rights. These audit rights must exceed the simple audit rights associated with the financial relationship between the parties and must allow a full review of all FCPA-related compliance procedures, such as those for meeting with foreign governmental officials and compliance-related training. The foreign business partner must agree that it will not hire an agent, subcontractor, or consultant without the

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company's prior written consent (to be based on adequate due diligence). The US company must retain a right to terminate the contract, in an immediate and unfettered manner, if there is evidence of any breach of compliance-related obligations.

After the contract is signed—Monitor, monitor, and then, monitor

In addition to the due diligence and contract guidelines above, a US company must implement a procedure to monitor the actions of the foreign business relationship going forward. In its DPA with the Monsanto Company for their FCPA violations, the DOJ provided some guidance on the continuing obligation to monitor foreign business partners. In the Monsanto DPA, the DOJ agreed, after the initial due diligence and appropriate review were completed on foreign business partners, for Monsanto to implement certain post-contract procedures. These requirements to Monsanto can be used as guidelines as to what the DOJ will look for from other US companies that are entering into relationships with foreign business partners, especially in the area of ongoing monitoring of the foreign business partner.

A US company should, on a periodic basis of not less than every three years, conduct rigorous compliance audits of its operations with foreign business partners. These audits would include, but not be limited to, detailed audits of the foreign business partner unit's books and records, with specific attention to payments and commissions to agents, consultants, contractors, and subcontractors who have responsibilities that include interactions with foreign officials and contributions to joint ventures. The compliance audit should include interviews with employees, consultants, agents, contractors, subcontractors, and joint venture partners. Lastly, a review of the FCPA compliance training provided to the foreign business partner should be included.

Conclusion

Managing the risk of a relationship with a foreign business partner is one of the most critical aspects of an FCPA compliance program. The documented risk to a US company is quite high for a foreign business relationship's violation of the FCPA. To engage a foreign business partner, in a manner that properly assesses and manages the risk for a US company, requires a commitment of time, money, and substantial effort. However, with a compliance-based risk management procedure in place, the risk can be properly managed and a foreign business relationship can be successful for all parties. ■

1 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Release No. 34-44969 (Oct. 23, 2001) ; available at http://www.sec.gov/litigation/investreport/34-44969.htm [commonly known as the "Seaboard Report"].

2 Paul J. McNulty, Deputy Attorney General, ,Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006); available at http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf.

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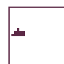
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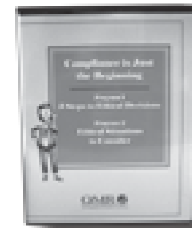

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