THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 46 No. 14 August 14, 2013

ANTI-CORRUPTION DUE DILIGENCE IN MERGERS AND ACQUISITIONS

The government's recently published Resource Guide *to the FCPA reinforces the importance of anti-corruption due diligence in mergers and acquisitions, particularly of foreign targets. Risks in such acquisitions are heightened by the broad range of prohibited acts and the far-reaching territorial jurisdiction of the FCPA. After reviewing the anti-bribery and accounting provisions of the statute, the authors turn to the assessment of risks, based on country, industry, and agency factors, and the conduct of due diligence to minimize them.*

By Adam M. Givertz and Brad D. Goldberg *

Enforcement of the Foreign Corrupt Practices Act (the "FCPA") continues to be a "high priority" for both the Securities and Exchange Commission and the Department of Justice.[1] In the last five years, the U.S. government has collected almost $4 billion in FCPA-related civil and criminal fines and settlements compared to approximately $300 million in the preceding five years.[2] Many of the key enforcement actions under the FCPA have arisen in the context of an acquisition, where the corruption has been uncovered prior to or following the closing of a transaction.[3] But it is not just the SEC and DOJ that are focused on anti-corruption enforcement: many other countries have also made anti-corruption a priority.[4]

[1] SEC, *Spotlight on FCPA*, http://www.sec.gov/spotlight/fcpa.shtml.

[2] Philip Urofsky *et al.*, *FCPA Digest: Cases and Review Releases Relating to Bribes to Foreign Officials under the Foreign Corrupt Practices Act of 1977: January 2013*, *available at* http://fcpa.shearman.com/.

[3] *E.g.*, *SEC v. RAE Systems Inc.*, No. 1:10-cv-02093 (D.D.C. 2010).

[4] *E.g.*, the United Kingdom Bribery Act 2010 (2010 c. 23); the Canadian Corruption of Foreign Public Officials Act (the "CFPOA") of 1998 (S.C. 1998, c. 34); People's Republic of China Criminal Law Art. 164; German Criminal Code § 331 *et seq*. Forty countries have adopted the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. *See* Organisation on Economic Co-operation and Development, *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (*footnote continues on next page…*),

∗ *ADAM M. GIVERTZ is a mergers & acquisitions partner in the Toronto office of Paul, Weiss, Rifkind, Wharton & Garrison LLP. BRAD D. GOLDBERG is a corporate associate also in the firm's Toronto office. Their e-mail addresses are agivertz@paulweiss.com and bgoldberg@paulweiss.com.*

RSCR Publications LLC Published 22 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $1,197 per year in U.S., Canada, and Mexico; $1,262 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call (866) 425-1171 or visit our Web site at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail shimmelfarb@comcast.net. To submit a manuscript for publication contact Ms. Himmelfarb. ISSN: 0884-2426.

In light of the global focus on anti-corruption enforcement, the fact that corrupt activities of a potential target can expose an acquirer to significant risk and the fact that mergers and acquisition transactions ("M&A") have been a key source of FCPA enforcement activity, no business combination should be entered into without robust analysis and investigation of any potential acquisition target to determine its "corruption risk." Indeed, the SEC and the DOJ's recently published *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (the "Resource Guide"),[5] which restates or clarifies many of the agencies' views and enforcement theories with respect to the FCPA, reinforces the importance of anti-corruption due diligence in M&A. Thus, the time is ripe for corporate attorneys to revisit best practices in assessing and mitigating the corruption risks that arise in connection with the acquisition of a foreign company or business.

SCOPE OF THE FCPA

Determining whether an acquirer will face penalties for a potential target's conduct under the FCPA requires an understanding of the scope of the statute. The FCPA is divided in two parts – the anti-bribery provisions and the accounting provisions – each of which creates a broad category of prohibited acts. Equally important as the breadth of these prohibitions is the far-reaching jurisdictional range of the FCPA.

Anti-Bribery Provisions

The FCPA's anti-bribery provisions contain five elements. They prohibit (1) an issuer, domestic concern, or person acting within the territory of the United States or agent thereof from (2) *corruptly* making an offer or payment (3) of anything of value (4) to any *foreign official*, directly or indirectly, for purposes of influencing such foreign official to act or fail to act in his or her official capacity (5) in order to assist such covered person in *obtaining or retaining business*.[6]

The first element, "issuer, domestic concern, or person acting within the territory of the United States or agent thereof" (collectively, "covered persons") determines whether a person is subject to jurisdiction of the FCPA. An "issuer" is any business entity, foreign or domestic, that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934 or that is required to file periodic and other reports with the SEC under Section 15(d) of the Exchange Act.[7] A "domestic concern" includes any business entity organized under United States law or that has its principal place of business in the United States.[8] A person is "acting within the territory of the United States" for purposes of the FCPA if such person engages in any act in furtherance of a bribe from within the

footnote continued from previous page…

http://www.oecd.org/corruption/oecdantibriberyconvention.htm. In February 2013, a bill was proposed to the Canadian parliament to augment the CFPOA with additional provisions, including an accounting offense similar to the FCPA's. Bill S14: An Act to amend the Corruption of Foreign Public Officials Act (2013); First Reading February 5, 2103; First Session, Forty-first Parliament. In the last two years, the Canadian government settled its two largest CPFOA enforcement actions: the first for $9.5 million and the second for $10.35 million. *Her Majesty the Queen v. Niko Resources Ltd.*, E-File No.: CCQ11NIKORESOURCES, June 24, 2011; *Her Majesty the Queen v. Griffiths Energy International*, E-File No.:CCQ13GRIFFITHSENER, Action No. 130057425Q1, January 25, 2013.

[5] *Available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

[6] 15 U.S.C. § 78dd (emphasis supplied). The CFPOA similarly states: "[e]very person commits an offence who, in order to obtain or retain an advantage in the course of business, directly or indirectly gives, offers, or agrees to give or offer a loan, reward, advantage, or benefit of any kind to a foreign public official or to any person for the benefit of a foreign public official (a) as consideration for an act or omission by the official in connection with the performance of the official's duties or functions; or (b) to induce the official to use his or her position to influence any acts or decisions of the foreign state or public international organization for which the official performs duties or functions." S.C. 1998, c. 34.

[7] 15 U.S.C. § 78dd-1.

[8] 15 U.S.C. § 78dd-2.

United States, whether directly or indirectly through an agent.[9]

The second element, "corruptly," is best understood as qualifying the offer or payment in question as one intended to induce the misuse of an official position.[10] Misuse of an official position covers a broad range of activities, including: directing the judgment of a tribunal in favor of a certain party,[11] directing the grant of government contracts,[12] or expediting customs clearances.[13] However, the government has noted that an offer or payment that facilitates a foreign government official's ability to attend a demonstration of a covered person's services or facility (*i.e.*, a so-called facilitation payment) would not give rise to liability.[14]

The third element, "anything of value," is also construed broadly. The term includes cash, gifts, meals and entertainment,[15] travel expenses,[16] charitable contributions,[17] campaign contributions,[18] and even college tuition.[19] While the FCPA does not recognize a *de minimis* exception, the Resource Guide notes that nominal values, such as cab fare, promotional items, or reasonable meal costs would unlikely be construed as payments of value.[20]

The fourth element, "foreign official," is defined broadly to include any officer or employee of a foreign government, or any department, agency, or instrumentality thereof or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization. The term includes obvious government employees such as customs officers, but also individuals who are employed by state-owned corporations or work in industries overseen by the government. In many countries, healthcare is a key example of the latter.[21] The SEC has indicated that even journalists who work for state-owned media outlets constitute foreign officials for purposes of the FCPA.[22] Importantly, the FCPA does not apply to payments made to governments themselves, but only to individuals working on behalf of such governments or to corporations owned by the state.[23]

The final element, "obtaining or retaining business," applies to a host of possible business advantages that inure to the payor, which will in most cases track the misuse of the foreign official's position that renders the payment corrupt.

Accounting Provisions

The FCPA's accounting provisions apply only to "issuers." The accounting provisions make no explicit reference to bribery and indeed apply to all kinds of accounting deficiencies. The importance of the accounting provisions is noted in the Resource Guide: "Although the accounting provisions were originally enacted as part of the FCPA, [the accounting provisions now] form the backbone for most accounting fraud and issuer disclosure cases brought by DOJ and SEC."[24] That said, given the accounting provisions' roots in the FCPA, it is safe to assume that the DOJ and SEC are especially sensitive to inaccuracies in an issuer's books and records designed to conceal or obscure bribery.

---

[9] 15 U.S.C. § 78dd-3.

[10] Resource Guide at 14.

[11] *U.S. v. Pride International Inc.*, No. 4-10:cr-7770 (S.D. Tex 2010).

[12] *U.S. v. Daimler AG*, No. 10-cr-63 (D.D.C. 2010).

[13] *U.S. v. Shell Nigeria Exploration and Production Company Ltd.*, No. 4-10:cr-767 (S.D. Tex. 2010).

[14] FCPA Review Opinion Procedure Release 11-01 (June 30, 2011). Whether a payment is corrupt or not can be a complicated question, as in many cultures gift-giving is a traditional courtesy in business transactions. For an analysis of the FCPA issues surrounding the culture of gift-giving in China, *see* F. Joseph Warin, Michael S. Diamant, and Jill M. Pfenning, *FCPA Compliance in China and the Gifts and Hospitality Challenge*, 5 Virginia Law & Bus. Rev. 1; *see also* Patrick M. Norton, *FCPA Compliance in China*, 40 Rev. Sec. & Comm. Reg. 137 (June 20, 2007).

[15] *SEC v. Eli Lilly and Co.*, No. 1:12-cv-02045 (D.D.C. 2012).

[16] *U.S. v. Data Sys. & Solutions, LLC*, No. 12-cr-00262 (E.D. Va. 2012).

[17] *SEC v. Schering-Plough Corp.*, No. 1:04-cv-00945 (D.D.C. 2004).

[18] *U.S. v. John Joseph O'Shea*, No. 09-00629 (S.D. Tex. 2009).

[19] *U.S. v. Control Components Inc.*, No. 09-00162 (C.D. Cal. 2009).

[20] Resource Guide at 15.

[21] *E.g.*, *United States v. Biomet, Inc.*, 12-cr-080 (D.D.C. 2012).

[22] FCPA Review Opinion Procedure Release 08-03 (July 11, 2008).

[23] *U.S. v. Novo Norodisk A/S*, No. 09-12C (D.D.C. 2009).

[24] Resource Guide at 38.

The FCPA's accounting provisions state that every issuer shall "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer" and "devise and maintain a system of internal accounting controls."[25] The former proscription is known as the "books and records" prong and the latter as the "internal controls" prong.

The "books and records" prong seeks to ensure that: "(1) books and records […] reflect transactions in conformity with accepted methods of reporting economic events, (2) misrepresentation, concealment, falsification, circumvention, and other deliberate acts resulting in inaccurate financial books and records are unlawful, and (3) transactions […] be properly reflected on books and records in such a manner as to permit the preparation of financial statements in conformity with generally accepted accounting principles and other criteria applicable to such statements."[26] In furtherance of these goals, courts have interpreted the books and records prong to include no scienter or materiality limitations.[27] Put another way, even a small and unintentional inaccuracy in an issuer's books and records can subject it to liability under these provisions. Because the liability threshold is so low, the SEC often charges companies under the accounting provisions, as it is typically easier to prove an accounting defect than an act of bribery itself.

The internal controls prong relates to a company's control system, "which is specifically designed to provide reasonable, cost-effective safeguards against the unauthorized use or disposition of company assets, and reasonable assurances that financial records and accounts are sufficiently reliable for purposes of external reporting."[28] Whether a company's internal controls are sufficient to satisfy the second prong of the accounting provisions cannot be reduced to a bright-line test, but at a minimum includes proper oversight of transactions by management and periodic comparisons of accounting records with actual assets.

Jurisdiction

As discussed above, jurisdiction under the FCPA is wide-ranging, giving the DOJ and SEC license to prosecute corrupt payments made by any U.S. domestic company, any U.S. issuer, or any other entity that commits an act in furtherance of bribery from within the United States. As a first measure when evaluating a potential target's corruption risk, an interested acquirer should assess whether it or the target is currently subject to FCPA jurisdiction and, if so, to what extent. For example, while the anti-bribery provisions apply to acts by issuers, domestic concerns, and persons acting within the territory of the United States, the accounting provisions apply solely to issuers.

When initially considering an acquisition, determining an entity's status as an issuer or a domestic concern should be a familiar exercise; the acquirer must simply look to whether each of it or the potential target files annual and periodic reports with the SEC and where it is incorporated and headquartered. Determining whether an entity is subject to the FCPA's territorial jurisdiction is less straightforward because discovering the basis for jurisdiction relies in part on discovering the fact of the bribery itself. That said, as discussed below, whether the target is subject to FCPA liability prior to an acquisition is significant in assessing the potential liability of an acquirer for the pre-transaction conduct of an acquired entity. Accordingly, to the extent that a potential acquirer uncovers bribery in the course of due diligence, it should keep in mind that such activity may establish the basis for pre-transaction FCPA liability for a target that is neither an issuer nor a domestic concern.

Successor Liability

The extent of an interested acquirer's FCPA liability for a target's pre-transaction conduct turns primarily on whether the target was subject to the FCPA prior to the transaction. On the one hand, if the target is neither an issuer nor domestic concern and has not committed an act in furtherance of bribery from within the United States, acts by the target that occurred prior to the transaction are generally insulated from FCPA enforcement.[29] On the other hand, if the target is already subject to the FCPA at the time the transaction is consummated, the acquirer could be held liable for the

[25] 15 U.S.C. § 78m(b)(2).

[26] *SEC v. World-Wide Coin Investments, Ltd.*, 567 F. Supp. 724, 748 (N.D. Ga. 1983).

[27] *Id*. at 749 ("Just as the degree of error is not relevant to an issuer's responsibility for any inaccuracies, the motivations of those who erred are not relevant.").

[28] *Id*. at 750.

[29] Resource Guide at 28 ("[I]f an issuer were to acquire a foreign company that was not previously subject to the FCPA's jurisdiction, the mere acquisition of that foreign company would not retroactively create FCPA liability for the acquiring issuer.").

target's pre-transaction FCPA violations, though, as discussed below, the strength of the acquirer's due diligence process is often viewed by the SEC and DOJ as justification to limit enforcement, including limiting prosecution efforts to only the newly acquired subsidiary. Still, it is important to be mindful of the fact that although a target may not be subject to the FCPA, any post-closing violations of the FCPA will create potential liability for any acquirer that is itself subject to the statute.

Moreover, while it is tempting to treat a non-U.S. entity with no operations or direct connection to the United States as posing no corruption risk from its pre-transaction conduct, this overlooks the FCPA's territorial jurisdiction. Though such an entity is neither an issuer nor a domestic concern, it may still have taken action from within the U.S. or relied on U.S. agents in the course of bribery. The DOJ has endorsed a liberal theory as to what constitutes a sufficient connection to the United States to give rise to territorial jurisdiction. In one illustrative case, a U.K. company was prosecuted under 15 U.S.C. § 78dd-3 (territorial jurisdiction) on the theory that e-mails and telephone calls from the company in Europe to its agent in Texas, directing its agent to facilitate a bribe to Nigerian customs officials, constituted a sufficient nexus with the United States.[30] The company ultimately pled guilty and paid a $4.2 million fine. In short, when acts of bribery are undiscovered, the details of such acts are equally unknown, and so an interested acquirer cannot dismiss the possibility of FCPA liability for a target's pre-transaction conduct until it is aware of the specifics of any such illegal conduct. Further, even when an entity is not subject to the FCPA, it may be subject to a similar anti-corruption regime in its home country instead, which could impose similar consequences.

Assuming a target is, prior to the acquisition, subject to FCPA jurisdiction by virtue of one or more of the above hooks, the SEC and DOJ have stated that they have often "pursued enforcement actions against the predecessor company (rather than the acquiring company), particularly when the acquiring company uncovered and timely remedied the violations, or when the government's investigation of the predecessor company preceded the acquisition."[31] That said, aside from reputational concerns, it is unclear to what extent this prosecution decision matters in the post-acquisition context, given that any economic penalties imposed on the target are of significant consequence to the acquirer once the target is wholly owned and the entities are financially consolidated. Accordingly, the first goal of anti-corruption due diligence should be to uncover the extent of the corruption risk posed by the acquisition. Armed with such information, an interested acquirer can assess whether the transaction is prudent and, if so, how to best mitigate any corruption risk.

ASSESSING RISK AND DIRECTING DUE DILIGENCE RESOURCES

FCPA violations carry a number of risks. Under the Alternative Fines Act, violations of the FCPA can carry a penalty of up to twice the gross gain or twice the gross loss resulting from a violation.[32] The penalties imposed have, in some cases, been very large. For example, in 2008, one foreign company faced a $1.6 billion penalty, $800 million of which was paid to U.S. authorities. Apart from the pure financial risk of an enforcement action, acquiring a company associated with bribery also carries the risk that contracts or permits so procured will ultimately have no legal effect or that the acquired entity's history of bribery will cause reputational damage to the acquirer.

As stated above, there is no *de minimis* concept or materiality standard in the FCPA. Consequently, materiality thresholds that may inform business, financial, or other legal due diligence in M&A generally have no application in the anti-corruption context. Akzo Nobel N.V., a multi-billion dollar company, was in 2012 prosecuted for allegedly paying only $280,000 in bribes to Iraqi officials, disguised as a series of 10% inflations on relatively small government contracts.[33] Were Akzo Nobel a potential acquisition target at the time, a due diligence process that set a materiality threshold of even US$1 million would have unlikely led to a review of such contracts. That said, significantly lowering materiality thresholds purely for purposes of anti-corruption due diligence may simply not be feasible or economical in many transactions. In practice, anti-corruption due diligence requires an acquirer to understand whether a target's country, industry, and business operations may pose a corruption risk and to focus resources where such risks lie. That said, anti-corruption due diligence should not be understood as valuable only as a means to detect existing corrupt practices. Such targeted due diligence should provide greater insight into a target's business integrity and internal controls, which, if weak, can justify abandoning a transaction, lowering the price, or beginning a dialogue

[30] *U.S. v. Aibel Group Ltd.*, No. 4:07-cr-00005 (S.D. Tex. 2008).

[31] Resource Guide at 29.

[32] 18 U.S.C. § 3571.

[33] *SEC v. Akzo Nobel, N.V.*, No. 07-cv-02293 (D.D.C. 2007).

with the government. Finally, while due diligence does not serve as an affirmative defense to FCPA charges, it may serve as evidence that the acquirer lacked the corrupt purpose or knowledge necessary to violate the statute.

Country Risk

One key indicator of a company's corruption risk is the countries in which it operates. Transparency International ("TI") publishes two useful indices to help estimate a company's propensity for corruption based on the locations of its operations. First, the Corruption Perception Index ranks countries by how prevalent bribery is within its public institutions.[34] In 2012, Somalia, North Korea, and Afghanistan tied for last place; Denmark, Finland, and New Zealand tied for first. Second, the Bribe Payers Index ranks certain countries by how likely companies based in each country are to engage in corruption abroad.[35] In 2011, of the (primarily developed) countries evaluated, Russian and Chinese firms were found most likely to engage in bribery. Dutch and Swiss companies were found to be the least likely to do so. Certainly, TI's guidance should be utilized to assist a potential acquirer in analyzing which acquisition targets, or business segments of a target, should receive heightened attention in anti-corruption due diligence. In addition, acquirers may also wish to look to SEC and DOJ enforcement patterns, as the U.S. government has developed more expertise in conducting investigations with respect to corruption in certain countries. For example, except for one case, all SEC and DOJ FCPA enforcement actions in Africa since January 2009 have in some way involved Nigeria. In that same time period, approximately a third of the SEC and DOJ's FCPA enforcement actions have included allegations of bribery in Mexico, Central America, or South America. Despite TI's analysis, no FCPA enforcement actions have thus far focused on bribery in Afghanistan, Somalia, or North Korea.

Industry Risk

The industry in which a business operates is also significant in evaluating its corruption risk. TI has ranked industry sectors by their propensity for bribery, finding that bribery is least likely in agriculture and most likely in public works construction, utilities, resource extraction, and healthcare.[36] DOJ and SEC enforcement patterns also show a significant interest in such sectors, with an especially high focus recently on healthcare and pharmaceuticals.[37] For purposes of accurately focusing attention during due diligence, it is worth noting that, for corruption purposes, the common feature of these problematic industries is that they are all sectors in which the government tends to exercise either monopoly or monopsony power, or in which government permits and regulation are fundamental to the operations of a business. While these are common, if not inherent, features of industries such as public works and resource extraction, governmental exclusivity can be legislated in virtually any sector of the economy. For example, in 2010, the DOJ and SEC prosecuted a number of companies and individuals for participating in a scheme to bribe the Thailand Tobacco Monopoly to ensure access to the Thai tobacco market.[38] Were Thailand not a country in which the government had established a state monopoly over tobacco, it would be less likely that a tobacco company would engage in bribery there.

Substantial government involvement in an industry can also increase corruption risk. In the pharmaceutical industry, various stages of the product lifecycle – from product approval to dispensing in a pharmacy – often involve government interaction or decision-making. The pharmaceutical industry's significant and repeated contact with government may well explain the DOJ and SEC's recent interest in the sector.[39] As one example, in 2012 a subsidiary of a pharmaceutical company agreed to pay a $15 million fine after it was charged with making corrupt payments in various Eastern European and Western Asian countries for the purpose of securing approval from regulators, purchase orders from hospitals and prescriptions of its drugs by doctors.

---

[34] TI, *Corruption Perception Index 2012*, http://cpi.transparency.org/cpi2012/results/.

[35] TI, *Bribe Payers Index Report*, http://bpi.transparency.org/bpi2011/results/.

[36] *Id*.

[37] *E.g.*, *U.S. v. Pfizer H.C.P. Corp.*, 12-cr-169 (D.D.C. 2012); *U.S. v. Orthofix Int'l N.V.*, No. 4:12-cr-150 (E.D Tex 2012); *U.S. v. Biomet Inc.*, 12-cr-080 (D.D.C. 2012); *U.S. v. Smith & Nephew Inc.*, 12-cr-030 (2012).

[38] *SEC v. Bobby J. Elkin, Jr., Baxter J. Myers, Thomas G. Reynolds, and Tommy L. Williams*, No. 1:10-cv-00661 (D.D.C. 2010); *SEC v. Universal Corp.*, No. 10-cv-1318 (D.D.C. 2010); *SEC v. Alliance One Int'l, Inc.*, No. 10-cv-01319 (D.D.C. 2010); *U.S. v. Universal Leaf Tabacos Ltda.*, No. 3:10-cr-225 (E.D. Va. 2010).

[39] *See* Gardiner Harris and Natasha Singer, *U.S. Inquiry of Drug Makers in Widened*, August 13, 2010, *available at* www.nytimes.com.

As acquirers gain insight into the industry customs in a given country, the corruption risk of the target's primary competitors should also be considered. This is important for two reasons. First, the value of a company whose competitors are willing to or likely to break the law in order to obtain business advantages might be lower than expected. Such a business climate both suggests pressure for the target's management to also engage in bribery or, if not, risk that the target's future business prospects will not altogether turn on its merits. Second, DOJ and SEC enforcement patterns reveal that when one instance of bribery is detected, the government will invest resources into uncovering any other entities who are also bribing those same officials for similar purposes or in similar ways, such as in the Thai Tobacco cases discussed above.[40] Operating in an area that is rife with corruption will, regardless of the target's actual practices, increase government scrutiny.

Accordingly, understanding not only the general risk of corruption in certain countries, but also how likely the government in a given country is to be significantly involved in a target's business, as well as the reputation of competitors in such a county will prove key in focusing anti-corruption due diligence resources. Interested acquirers should ensure that in the course of anti-corruption due diligence, they compile a list of state-owned corporations in each jurisdiction in which the target operates to assess the degree to which the target's business implicates governmental relationships.

Agency Risk

The FCPA's anti-bribery provisions subject an entity to liability for acts of bribery undertaken by the entity's agent as long as the entity, at a minimum, is aware that a bribe on its behalf is substantially certain to occur. The Resource Guide explains that "[a]s Congress made clear, it meant to impose liability not only on those with actual knowledge of wrongdoing, but also on those who purposefully avoid actual knowledge."[41] Indeed, a large number of FCPA enforcement actions brought by the DOJ and SEC involve allegations that a third-party affiliate of the defendant served as an intermediary to effect the bribe. In some cases, the prosecuted entity is accused of directly instructing its third-party agent to complete the bribe on its behalf.[42] In other cases, the third-party agent is arguably acting without direct instruction, but the prosecuted entity nevertheless disregarded the risk that its agent was making corrupt payments on its behalf.[43] Understanding the reputation and history of a potential acquisition target's principal agents, consultants, and distributors can go a long way towards weighing its corruption risk. However, interested acquirers should be aware that any substantial use of foreign third-party agents will lead to increased corruption risk, as entities have less ability to control third parties, who may be much more willing to engage in corruption or arrangements that could draw scrutiny. Accordingly, in all cases where a target relies on third-party agents to liaise with foreign officials, an interested acquirer should ensure that the target's agents understand the applicable anti-corruption laws and policies, and have provided representations and covenants regarding their compliance with such laws and policies.

CONDUCTING DUE DILIGENCE

No matter how low a target's corruption risk appears at first blush, the SEC and DOJ expect that an acquirer's due diligence will include formal anti-corruption due diligence.[44] The primary goals of such an exercise should be to: (1) focus resources on the aspects of the target's business and internal control program that are most likely to reveal existing corrupt practices or insufficient oversight; (2) take reasonable steps to identify such issues; and (3) put in place a plan to remediate any existing issues and to prevent future violations.

Public information is the best place for an interested acquirer to begin; firms can be retained to conduct desktop reviews as an initial step.[45] Once the corruption risk of a potential acquisition target has been assessed at a high level, and the acquirer remains motivated to pursue the transaction, the acquirer should appoint a

[40] As another example, enforcement actions have been instituted against a range of different companies and individuals to penalize kickbacks paid to Iraqi officials in connection with contracts entered into under the United Nations Oil-for-Food Program. *See, e.g., SEC v. General Electric Co.*, No. 10-cv-01258 (D.D.C. 2010); *SEC v. Daimler AG.*, No. 10-cv-00473 (D.D.C. 2010); *SEC v. Innospec, Inc.*, No. 1:10-cv-0048 (D.D.C. 2010); *SEC v. AGCO Corp.*, No. 1:09-cv-1865-RMU (D.D.C. 2009).

[41] Resource Guide at 22.

[42] *SEC v. Comverse Technology Inc.*, No. 11-cv-1704 (E.D.N.Y. 2011).

[43] *SEC v. Armor Holdings, Inc.*, 1:11-01271 (D.D.C. 2011).

[44] Resource Guide at 62.

[45] There are several service providers that offer a high-level corruption risk-assessment and investigation using their own databases, media searches, and other publicly available information.

member of senior management to be responsible for formal anti-corruption due diligence. Anti-corruption due diligence should at all times be integrated into the standard due diligence process, but the acquirer should establish dedicated internal and external anti-corruption due diligence teams who are well versed in both the FCPA, the acquirer's internal anti-corruption policies, and the areas of high corruption risk posed by the target. Since corruption will in most cases be disguised, these teams should include representatives with expertise in law, forensic accounting, and finance, as it will generally take a combination of different skill sets to pose the right questions to the target's management and investigate red flags. The acquirer should be sure to establish a timetable that is adequate and effective for anti-corruption due diligence so that the process will not be rushed. Most importantly, the acquirer should, at the outset, establish a protocol to respond to real or suspected corruption discovered in the course of due diligence, including establishing lines of communication with counsel to preserve legal privilege.

Review of Target's Formal Anti-Corruption Program

When a target can show an existing commitment to stamping out corruption, an acquirer should feel more confident about the target's corruption risk. Early on in the course of due diligence, the anti-corruption due diligence team should become familiar with the target's existing formal anti-corruption policy and feel comfortable with its past implementation. Interested acquirers should look for a robust, enterprise-wide, anti-corruption program that is explained in a written protocol, provided to and signed by all employees of both the target and any of its subsidiaries. The protocol should teach the fundamental principles of the FCPA and bribery generally, including the distinction between acceptable, small gifts to foreign officials and unacceptable corrupt payments. Key individuals in the organization should attend periodic training seminars on FCPA compliance. A strong anti-corruption program will often require any payments to government officials (or payments to third parties that interface with government officials on behalf of the target) to be approved by a designated senior officer of the company; in cases where such a program exists, the interested acquirer's due diligence request list should include copies of all such approval requests in recent years. With an especially close focus on riskier areas of operations, the anti-corruption due diligence team should review such records to ensure that their frequency and pattern of acceptance and denial is appropriate in light of the target's business. A policy of requiring senior review of payments to government officials is only worthwhile if such review is in fact conducted and is more than a rubber stamp. The due diligence request list should further request all reviews, reports, or audits, internal and external, carried out on the implementation of the target's anti-corruption program. To the extent that the target has learned of past instances of corruption in its line of business or has previously received proposals from potential agents that intimated corruption, the target ideally keeps and maintains a "blacklist" of corrupt foreign officials and third parties with whom it will not deal.

A strong anti-corruption program also provides a mechanism for employees to anonymously report information or suspicions with respect to bribery without fear of reprisal. Such reports should be followed up by a well-documented internal investigation, and the anti-corruption due diligence team should review such reports to determine they are satisfactory and that alerts were investigated in good faith.

Finally, the target's anti-corruption program should include records of its own anti-corruption due diligence investigations in the course of prior acquisitions and the retention of third-party agents abroad. The anti-corruption due diligence request team should review these analyses, focusing on their rigor and completeness.

Review of Target's Informal Anti-Corruption Commitment

While a formal anti-corruption due diligence regime is the ideal, the reality is that if the target is domiciled in a foreign country it is highly likely that it will have no formal anti-corruption policy. Even more so if the target is private. Accordingly, the due diligence process should also include interviews of the target's board of directors, management, shareholders, key employees, and agents. These interviews should inquire into the individuals' understanding of the FCPA or other applicable anti-corruption law and gauge their commitment to opposing bribery. Management should also be asked to provide information on any corruption incidents or investigations. The anti-corruption due diligence team should request a list of employees whose daily responsibilities involve liaising with foreign officials and, to the extent practicable, also interview such personnel. An interested acquirer should ensure it is aware of any employees, directors, officers, or affiliates of the target who have been previously disciplined for violating anti-corruption guidelines or laws. Public records, media reports, and discussions with outside parties about the reputations of the target and its key executives are an important way to glean valuable insight that may not be reflected in the company's formal documentation.

The anti-corruption due diligence team should further focus on the specific government officials with whom the target interacts. After determining the countries in which the target relies substantially on governmental relationships, the anti-corruption due diligence team should request a list of the specific officials with whom the target and its agents deal on a regular basis. If any such officials (or others in such official's office) have been implicated in corruption scandals, the anti-corruption due diligence team should review as thorough a record as possible of interactions between the target and such official or office.

Accounting Review

Scrutinizing the target's books and records is arguably the best way to detect past act of bribery. In addition, in the case of targets who qualify as issuers, such an audit is crucial to give comfort to the interested acquirer that the target has not violated the FCPA's accounting provisions. Where a potential risk has been identified, forensic accountants can be retained to investigate the financial records for red flags and to confirm the sufficiency of existing internal financial controls. Though not an exhaustive list, the following should give an interested acquirer concern that corrupt payments are potentially being made and concealed:

- checks, money orders of banking payments being drawn to cash or where the recipient of such payments otherwise is not being clearly identifiable;
- payments identified by vague descriptors such as "sales commissions," "consultant fees," "customs fees," "customs advice," "verification fees," "other expenses," or "miscellaneous";[46]
- payments identified with atypical descriptors such as "customs vacation," "customs escort," or "costs extra police to obtain visa";[47]
- evidence of frequent small payments to the same payee, especially if senior management review under the anti-corruption policy is triggered by payments in excess of a certain dollar threshold;
- rounded payments;
- missing or vague invoices from suppliers, in particular by overseas sales agents, customs agents, consultants, or distributors;
- invoicing by multiple suppliers in the same foreign country for similar services;
- special purpose vehicles used for transactions that would not typically warrant them;[48]
- payments to airlines, hotels, or other travel-related entities with no easily discernible corporate purpose;
- payments to individuals in foreign countries;
- joint ventures between the target and a foreign government;
- campaign contributions or charitable contributions abroad; and
- high or frequent employee reimbursement requests from employees who deal with foreign counterparties.

Stress-Testing

One of the more creative anti-corruption due diligence strategies involves "secret-shopping" the target to test the effectiveness of its anti-corruption program. A representative of the acquirer (whose true identity is unknown to the target) might pose as a customs agent and contact the target with a proposal to provide expedited customs clearance in a given country without a satisfactory explanation for how this is to be achieved. The potential acquirer can then assess how the target handles its response. Ideally, the target's management is trained to identify this proposal as potentially corrupt and either dismiss it or accompany any expression of interest with the appropriate anti-corruption due diligence. Since the secret-shopper's proposal will be designed to provide inadequate assurances, the target's inquiry, if any, should result in the secret-shopper being blacklisted. However, if the target pursues a formal relationship with the secret-shopper, this should give the potential acquirer pause about the target's anti-corruption controls and resolve.

Remediation

After conducting due diligence, the fact that a target has an imperfect record with respect to corruption issues

[46] SEC Accounting and Auditing Enforcement Release No. 3255 (Mar. 24, 2011).

[47] *SEC v. GlobalSantaFe Corp.*, No. 1:10-cv-01890-RMC (D.D.C. 2010).

[48] SEC Accounting and Auditing Enforcement Release No. 68448 (Dec. 13, 2012).

does not necessarily mean the transaction must be abandoned. While past FCPA violations are never washed away by a business combination, the SEC and DOJ's enforcement trends have shown a significant appreciation both for companies that strive to stamp out corruption in newly acquired subsidiaries and those that are forthcoming about past violations of the FCPA. Indeed, the SEC and DOJ recently entered into its first ever non-prosecution agreement, stating it "has determined not to charge [the Company] with violations of the FCPA due to the company's prompt reporting of the violations on its own initiative, the completeness of the information it provided, and its extensive, thorough, and real-time cooperation with the SEC's investigation."[49] In cases where newly acquired subsidiaries have previously violated the FCPA, but, due to the efforts of its new management, have improved their internal controls, the SEC and DOJ will typically only pursue an action against the predecessor company.[50]

The SEC and DOJ are loathe to allow an acquirer to avoid FCPA liability for either continuing, post-transaction violations by its new subsidiary or for unremedied pre-transaction violations that due diligence caught or should have caught. The SEC and DOJ have pursued actions against acquirers who discovered corrupt practices in the course of due diligence but failed to do more than instruct the target to cease such practices.[51]

Contractual Protections

Assuming that the work of the anti-corruption due diligence team suggests the target poses a low enough corruption risk to proceed with the transaction, the acquirer should always seek representations, warranties, and covenants regarding past and future compliance of the target company and its directors, officers, employees, affiliates, and agents compliance with the FCPA and other applicable anti-corruption or anti-bribery legislation, regulation, conventions, or policies. To the extent the target is a private company, the acquirer may also consider seeking indemnification from the sellers for any losses resulting from a breach of such representations, warranties, and covenants. Although contractual provisions are recommended, they can never serve as a replacement or proxy for a thorough due diligence investigation.

No-Action Relief

The Resource Guide discusses the possibility of receiving a no-action opinion from the DOJ and SEC with respect to the potential for an FCPA prosecution of a target.[52] The Resource Guide suggests such requests are atypical, but discusses one example in which Haliburton, as acquirer, received relief from prosecution for pre-transaction conduct by the target and any post-transaction conduct by the target disclosed within 180 days of closing.[53] While a formal opinion provides significant assurances to an acquirer, the Resource Guide notes that "because of the nature of such an opinion, it will likely contain more stringent requirements than may be necessary in all circumstances."[54] In cases where pre-transaction anti-corruption is not feasible, such as a competitive bidding situation, post-transaction due diligence in conjunction with the sort of no-action relief obtained by Haliburton can substantially ameliorate corruption risk.

CONCLUSION

Companies that engage in bribery do so in secret. This concealment of corruption poses a challenge not only for prosecutors, but also for outsiders who need to understand the risks in acquiring the company. While anti-corruption due diligence cannot ensure all hidden risks have been exposed, it often does reveal problems, which in turn allow for remediation or adjustment of deal terms to reflect the acquirer's additional risk exposure. Perhaps more importantly, an anti-corruption due diligence process that teaches an acquirer about its new subsidiary's dealings with foreign officials is quite useful in preventing corruption in the future. Such work should be followed through as intently as possible in the course of any business combination. ■

---

[49] *See* SEC News Release No. 2013-65, April 22, 2013 *at* http://www.sec.gov/news/press/2013/2013-65.htm.

[50] *U.S. v. Syncor Taiwan, Inc.*, No. 02-cr-1244 (C.D. Cal. 2002).

[51] *SEC v. RAE Systems Inc.*, No. 1:10-cv-02093 (D.D.C. 2010).

[52] Resource Guide at 29.

[53] *See* DOJ Opinion Procedure Release No. 08-02, June 13, 2008.

[54] Resource Guide at 29. *See also* DOJ Opinion Procedure Release No. 04-02, July 12, 2004 (No-action relief afforded to acquirer of two entities that already pled guilty to FCPA violations, noting that acquirer represented to conducting 44,700 hours of due diligence by 115 lawyers.).