

National Bar Association - Commercial Law Section

Leading Practices in FCPA Mergers &
Acquisitions Due Diligence

Thursday, February 23, 2017



Agenda

:

- Perspectives on expectations for Foreign Corrupt Practices Act (FCPA) M&A due diligence
- Leading practices and common challenges in performing FCPA M&A due diligence
- Q&A

Perspectives on
expectations and
approaches to FCPA
M&A due diligence

Elements of effective compliance programs

1. Commitment from senior management and a clearly articulated policy against corruption
2. Code of conduct and compliance policies and procedures
3. Oversight, autonomy, and resources
4. Risk assessment
5. Training and continuing advice
6. Incentives and disciplinary measures
7. Third-party due diligence and payments
8. Confidential reporting and internal investigation
9. Continuous improvement: periodic testing and review
- 10. Mergers and acquisitions: pre-acquisition due diligence and post-acquisition integration**

Source: Criminal Division of the U.S. Department of Justice and Enforcement Division of the U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (Nov. 14, 2012)

Highlights from the Resource Guide to the U.S. Foreign Corrupt Practices Act, 2012

“A company that does not perform adequate FCPA due diligence prior to a merger or acquisition may face both legal and business risks. Perhaps most commonly, inadequate due diligence can allow a course of bribery to continue—with all the attendant harms to a business’s profitability and reputation, as well as potential civil and criminal liability. In contrast, companies that conduct effective FCPA due diligence on their acquisition targets are able to evaluate more accurately each target’s value and negotiate for the costs of the bribery to be borne by the target.”

Source: Criminal Division of the U.S. Department of Justice and Enforcement Division of the U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (Nov. 14, 2012).

Highlights from the Resource Guide to the US Foreign Corrupt Practices Act, 2012

DOJ and SEC encourage companies engaging in mergers and acquisitions to:

1. Conduct thorough risk-based FCPA and anti-corruption due diligence on potential new business acquisitions;
2. Ensure that the acquiring company's code of conduct and compliance policies and procedures regarding the FCPA and other anti-corruption laws apply as quickly as is practicable to newly acquired businesses or merged entities;
3. Train the directors, officers, and employees of newly acquired businesses or merged entities, and when appropriate, train agents and business partners, on the FCPA and other relevant anti-corruption laws and the company's code of conduct and compliance policies and procedures;
4. Conduct an FCPA-specific audit of all newly acquired or merged businesses as quickly as practicable; and
5. Disclose any corrupt payments discovered as part of its due diligence of newly acquired entities or merged entities DOJ and SEC will give meaningful credit to companies who undertake these actions, and, in appropriate circumstances, DOJ and SEC may consequently decline to bring enforcement actions

“[Another] option is to seek an opinion from DOJ in anticipation of a potential acquisition . . . As a practical matter, most acquisitions will typically not require the type of prospective assurances contained in an opinion from DOJ.”

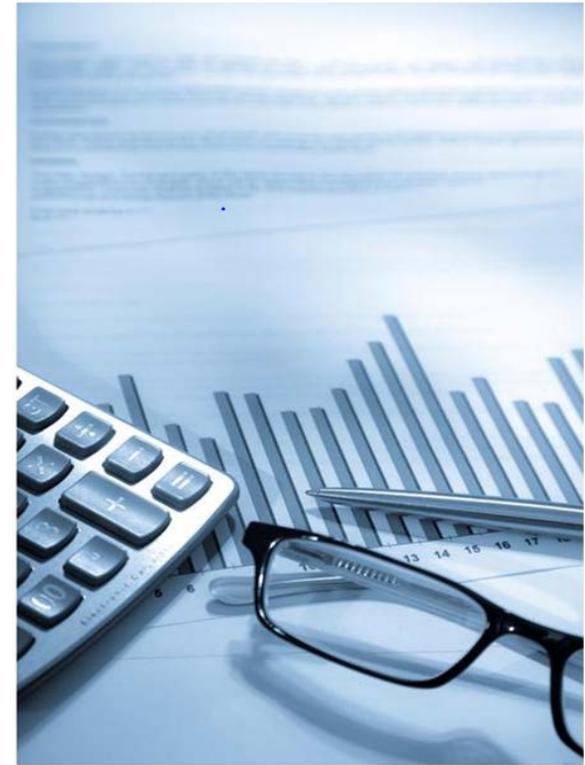
Pre-acquisition due diligence considerations

- Acquisition Due Diligence

1. Inadequate due diligence and failing to respond to red flags may give rise to violations
2. There is great fear that companies will be held liable for the pre-acquisition conduct of acquired companies

- 3. Regulators: discover, disclose and remedy**

- Create customized due diligence questionnaires
- Conduct thorough document review
- Interview key personnel in various departments
- Focus on third-party agents/consultants/payments
 - **Purpose of consulting**
 - **Contracts and certifications of compliance**
 - **Nature and amount of payments (excessive)**
 - **Form of payments:**
 - **Unapproved or unknown recipients**
 - **Wires to countries where no business conducted**
 - **Use of disreputable banks**
- The DOJ may ask to see examples of pre-transaction due diligence reports and the work performed



Illustrative due diligence approach

- **Scoping and planning, including:**
 - Understanding of target operations, structure, corruption risk profile, anti-corruption compliance program and controls.
- **Conduct initial due diligence which may include:**
 - Management inquiries,
 - Analysis of target policies and procedures,
 - Obtaining an understanding of target's corruption risk profile, anti-corruption compliance program, and
 - Risk-based, third-party contract analysis and transaction testing (e.g., payments to consultants, agents, and other higher-risk third parties).
- **Summarize risk assessment and initial gap analysis,** based on qualitative and quantitative factors, and information learned through initial due diligence.
- **Conduct additional in-country due diligence procedures based upon initial due diligence results, which may include:**
 - Analysis of high risk accounts and transactions and in-country transaction testing,
 - Additional management inquiries,
 - Analysis of third party contracts, and
 - Supplemental due diligence into individual third parties.
- **Develop a post-acquisition integration plan, as applicable, implement:**
 - supplemental due diligence procedures,
 - compliance program rollout, and
 - training.

Buyer's versus Seller's perspective

Buyer's perspective

- **What information is “mission critical” to FCPA due diligence?**
 - Pre-acquisition
 - Post-acquisition
- **What are common challenges encountered in conducting due diligence? What are some examples of successful tactics for navigating such situations?**
 - Data requests/access to information
 - Time constraints
 - Identification and resolution of red flags
 - Reporting if irregularities are found

Seller's perspective

- **What can sellers do to better prepare for a potential acquisition?**
 - Anti-corruption compliance/acquisition readiness assessment
 - Due diligence materials
 - Post-acquisition integration planning

FCPA Due Diligence Scenarios

FCPA due diligence scenario – low risk profile

Diligence during a transaction may reveal that while the entity subject to diligence presents no FCPA red flags, it also has no FCPA policies or compliance program.

Pre-acquisition:

- Ensure acquisition/investment agreements contain appropriate anti-bribery representations and warranties
 - Representations and warranties should cover full range of conduct that may violate applicable anti-bribery laws (e.g., commercial bribery if subject to UK Bribery Act), including broad definition of “anything of value” and “foreign official;”
 - Ensure time period covered by representations and warranties is at least five (5) years (the FCPA’s statute of limitations); and
 - Avoid knowledge and materiality qualifiers.
- Include an indemnification right in the agreement.

Post-acquisition:

- Develop and implement anti-corruption policies and procedures and internal controls
- Employee training, particularly management, high-risk personnel, accounting and finance staff
- Review of third-party relationships and written agreements

FCPA due diligence scenario – high risk profile

Diligence during a transaction may also reveal that the entity subject to diligence has FCPA concerns still under investigation or other red flags.

Pre-acquisition:

- Assess the risk profile – will the transaction go forward?
- Liability for pre-closing conduct depends on whether there was jurisdiction over the conduct and the actor, as well as the nature of the investment and structure of the transaction
- No successor liability if target's conduct not previously subject to FCPA; however, post-acquisition, target's operations become subject to FCPA if acquiring firm is subject to FCPA (e.g. Goodyear enforcement action)

Post-acquisition – DOJ and SEC suggestions:

- Reasonable, good-faith pre-acquisition due diligence
- Effective anti-corruption risk-assessment
- Post-acquisition integration plan for instituting policies and procedures, employee training, conducting due diligence, and remediation
- Disclosure

Examples of other considerations

Post-transaction integration

- Were employees of the acquired company incorporated into the acquiring company's internal controls? If so, how quickly were "boots on the ground"?
- What was the post-acquisition plan? The DOJ may ask the company to describe it in detail and to see documentation of the same.
- Was integration performed in a risk-based way?
- As part of the integration, did the company focus on past issues and issues identified in the pre-transaction due diligence (e.g., how were issues identified during the due diligence tracked post-transaction?)

M&A Liability and Enforcement Actions

M&A liability/transactions considerations

Liability

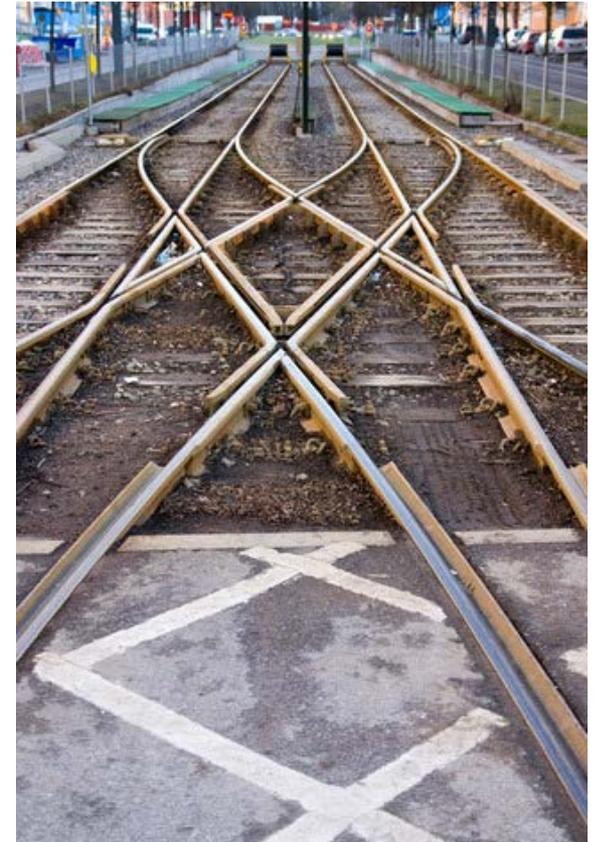
Legal ramifications potential buyers should keep in mind

- Buyer may be liable for target company's pre-acquisition FCPA violations
- Successor liability

Transaction

Legal implications may differ depending on the type of M&A transaction

- Stock transfer/merger vs. asset purchase



Enforcement Actions in M&A Context

2009

- Global Engineering and Construction firm
 - Senior executives conspired to bribe Nigerian government officials in order to obtain Oil and Gas engineering contracts worth over \$6 billion.
 - In order to conceal the illicit payments, the firm entered into “sham” consulting agreements with intermediary companies, who would funnel the bribe money to government officials.
 - After contracts were awarded and bribes were paid, the offending company was acquired by a larger parent company.
 - The acquiring company failed to implement adequate internal controls and, therefore, failed to detect, deter or prevent the illicit payments. As a result, the companies’ books and records contained false information.
 - Resulted in \$579 million settlement.¹

2016

- Information Technology Company
 - Former Chairman/CEO of the corporation's Chinese subsidiary facilitated a bribery scheme in which illegal gifts were given to government officials in order to obtain and retain business. In furtherance of the scheme, false information was knowingly entered into books and records.
 - When the corporation was later acquired, the parent company was not charged with FCPA violations because they implemented thorough internal controls, detected the bribes, and promptly self-reported.
 - “The SEC determined not to bring charges against [the Parent company], taking into consideration the company's efforts at self-policing that led to the discovery of [the CEO's] misconduct shortly after the acquisition, prompt self-reporting, thorough remediation, and exemplary cooperation with the SEC's investigation.”²

¹ SEC, Litigation Release No. 20897A / February 11, 2009 (<https://www.sec.gov/litigation/litreleases/2009/lr20897a.htm>)

² SEC Administrative Proceeding ,File No. 3-17535 (<https://www.sec.gov/litigation/admin/2016/34-78825-s.pdf>)

Today's Speakers

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Ms. Cross is a Principal in the Forensic practice of Deloitte Financial Advisory Services LLP. She has over 20 years of experience spanning business/financial strategy, financial management, internal controls, and anti-corruption compliance and investigations. While at Deloitte, she has participated in numerous engagements assisting clients in evaluating anti-corruption compliance programs, conducting corruption and fraud-related investigations, assessing internal controls and remediating control deficiencies. In addition, she has participated in variety of corporate reorganization projects. Ms. Cross' industry specialties include technology, telecommunications, aerospace/defense and medical devices. She has led projects in China, Brazil, India, Russia, Mexico, Turkey, Nigeria and other emerging markets.

Prior to joining Deloitte, Ms. Cross held strategy and financial positions at a large aerospace company. While at Lockheed Martin, she worked on a variety of business and financial strategy projects including: performing market and competitive analysis, supporting the development and implementation of international business strategies, evaluating joint venture/strategic alliance/M&A opportunities, developing business plans, investment analyses and valuation models, and analyzing financing alternatives. In addition, Ms. Cross held program finance and financial planning & analysis positions.

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Z Scott is a Partner in the Litigation group with a global law firm. She is widely recognized for compliance, litigation and anticorruption experience. She has substantial experience representing companies and individuals in complex commercial litigation, corporate internal investigations (including matters related to the Foreign Corrupt Practices Act), counseling on corporate compliance matters and white collar criminal defense. She has taken more than 40 mostly jury trials to verdict in federal court. She has led and represented companies in complex and extensive government regulatory and criminal grand jury investigations. She has briefed and argued cases before the Seventh Circuit Court of Appeals.

She is the former Executive Inspector General for the Office of the Governor of Illinois - established and managed an internal compliance and investigative agency for the Illinois government and Illinois public universities. She is the former federal criminal prosecutor with the U.S. Attorney's Office for 16 years, where she held various management positions, including chief of the general crimes section. She is recognized by Leading Lawyers 2015 as one of the Top 10 Leading Women Criminal Defense Lawyers in Illinois. Per Chambers USA: "Z is the lawyer we would call in our most significant internal investigations." Per the Legal 500: "[Z has an] impeccable reputation among clients."

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With a background in mergers and acquisitions, joint ventures and related issues, Marc Rawls works with both privately and publicly held companies in acquisitions, restructuring transactions, joint ventures and both private and public securities offerings. Marc also counsels clients in a variety of industries on corporate governance matters. He regularly advises on transactions involving capital formation, including securities offerings, and intellectual property licensing arrangements for businesses, and has particular experience in structuring complex franchise, limited liability and partnership arrangements, including public private partnerships.

Marc works extensively with firms in the water industry. Among other matters, he assisted Culligan International in numerous acquisitions and dispositions of bottled water franchises and guided Veolia Water North America, Inc. and Veolia Energy North America, Inc. through more than 50 acquisitions and dispositions of water waste treatment and energy assets. Marc also provides counsel on transactions in the payment card, electronic commerce, software and energy industries.

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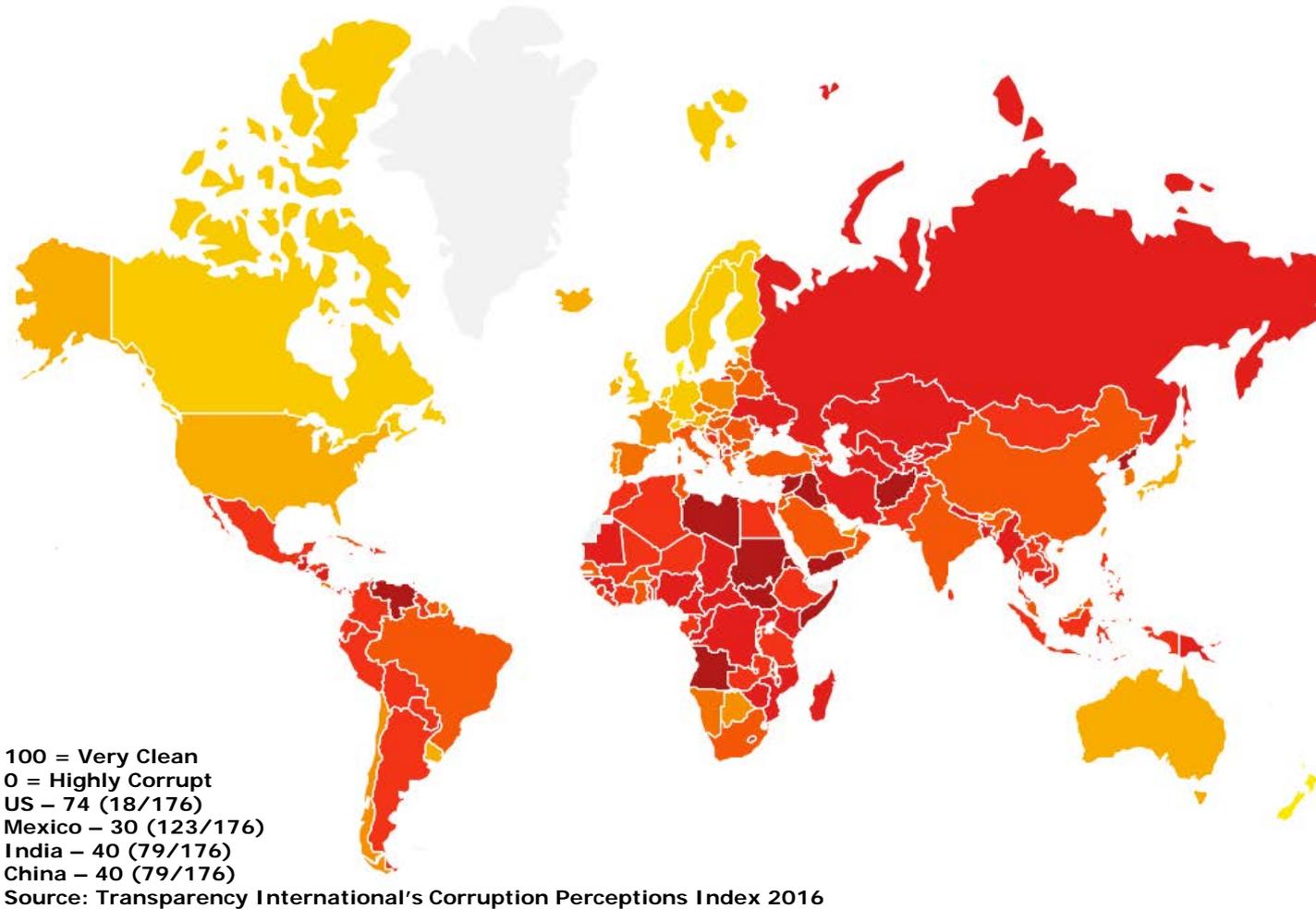
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Holly Loiseau is a litigation partner and a member of the firm's Complex Commercial Litigation and White Collar Defense and Investigations practices in the Washington, DC office. Ms. Loiseau's litigation practice is dynamic and diverse. Currently, she focuses her practice on representing companies and individuals in investigations related to the Foreign Corrupt Practices Act and other anti-corruption laws and the False Claims Act. She has represented and advised clients in grand jury proceedings and Congressional and internal investigations and she counsels clients with respect to compliance issues. In addition to investigations matters, she has litigated and tried cases in a variety of fields, including antitrust, trade regulation and false advertising, product liability, insurance coverage, tax, bankruptcy, contracts, derivative transactions, healthcare, and international trade. She has extensive experience litigating large consumer class actions and multi-jurisdictional cases for clients in various industries, and has achieved significant victories for clients on motions to dismiss, motions for summary judgment, and oppositions to class certification motions. Ms. Loiseau has litigated and resolved numerous bankruptcy related disputes for both debtors and creditors in court, arbitration and mediation.

Ms. Loiseau is deeply involved in the academic and legal community and speaks often on investigations, compliance, FCPA and anti-corruption enforcement issues, class actions and data privacy and protection. She has been a featured speaker at events sponsored by the American Bar Association, the National Bar Association, Deloitte Financial Advisory Services, the Association of Corporate Counsel and AICPA. She also speaks frequently regarding diversity and inclusion, having served as President of the Women's Bar Association of the District of Columbia and as a long-time member of Weil's Diversity Committee.

Appendix

Where is the Corruption?



FCPA vs. U.K. Bribery Act

FCPA (Effective 1977)

Prevent competitive advantage through bribery.

2 Parts: anti-bribery and accounting and

Internal controls provision

1. Covers issuers, U.S. "domestic concerns" and agents
2. Focuses on bribes of foreign officials ("FO")
 - Making a payment to a person defendant knew or believed to be a FO
 - Or where defendant knew all or portion of money would be offered, given, or promised directly or indirectly to a FO

Criteria: Money/Value exchange

+FO+purpose of obtaining/retaining business/mail or interstate commerce

3. Books and records violations are independent basis of liability
4. Allows "facilitation payments"

"[t]o expedite or to secure the performance of a routine governmental action . . . "an action which is ordinarily and commonly performed by a foreign official".

1. No liability
2. Recipients of bribes are not covered

U.K. Bribery Act (Effective July 2011)

1. Covers private citizens and companies which "carry on business" in the U.K.
2. Bribes don't have to be of foreign or government officials
3. Established a "Prevention Offense" which is strict liability
4. No exception for facilitation payments **(These types of payments were illegal even before the Bribery Act)**
5. Defense to Prevention Offense is having appropriate procedures
6. Recipients of bribes can be charged
7. Hospitality is not prohibited by the Act

Penalties:

Individuals can face up to 10 years in prison and an unlimited fine. Companies can also face unlimited fines.

FCPA Leading Practices

- Identify high-risk countries and high-risk business activities
- Conduct annual compliance policy review and updates
- Draft policies governing facilitation payments
- Expand application of internal policies to outside vendors and agents
- Appoint a senior corporate executive to oversee compliance policy who directly reports to a board committee

The U.K. Guidance on Bribery Act of 2011

Leading Practices for Prevention

- International businesses struggle with their responsibilities to monitor and control the conduct of third parties with whom they do business: distributors and sub-distributors, joint venture partners, dealers, and resellers
- Senior management's commitments to culture of compliance
- Rigorous and appropriate procedures
- Annual risk assessments
- Due diligence on acquisitions and new business endeavors
- Communication and training to employees and third-party providers
- Monitoring and external validation
- Reports to board of directors

Red Flags in Conducting FCPA Due Diligence

Understanding and responding to red flags

- **Were red flags identified in connection with third-party payments or other due diligence procedures? For example:**
 - Excessive commissions paid to third parties
 - Unusually large discounts given to third party distributors
 - Payments to third party made outside of normal payment processes, such as advance payments, payments made in cash or payments sent to offshore bank accounts, payments remitted to another third party
 - Lack of supporting documents and/or evidence of services rendered

- **How were red flags identified through due diligence resolved?**
 - What was the nature of the red flag/issue?
 - What was the source information?
 - Was information corroborated through additional due diligence procedures (e.g., deeper level of due diligence)?
 - To the extent corroborated, how were red flags or other risk issues mitigated (e.g., post-acquisition integration planning)?
 - Were issues identified escalated to appropriate levels within the company?

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