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Anti-Corruption Due Diligence In Corporate Transactions: One Size Does Not Fit All

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United States and European regulators continue to place a high priority on anti-corruption enforcement. In December 2008, Siemens AG paid more than \$1.1 billion to resolve anti-corruption investigations in the U.S. and Germany. The U.K. Financial Services Authority fined Aon Ltd. £5.25 million in January 2009, for failing to maintain adequate anti-bribery controls. In February 2009, Halliburton and Kellogg, Brown & Root agreed to pay a \$402 million criminal fine and to disgorge \$177 million in profits to settle anti-bribery investigations. In mid-2009, construction firm Mabey & Johnson pleaded guilty to U.K. anti-bribery violations. In July 2009, Utah-based Nature's Sunshine Products, Inc. and its Chief Executive Officer and former Chief Financial Officer, settled civil bribery, securities fraud, and accounting charges with the U.S. Securities and Exchange Commission (SEC). Also in July 2009, California manufacturing company Control Components, Inc. pled guilty to making improper payments to officials and private individuals in China, Korea and Malaysia to obtain and retain business.

Authorities have continued to emphasize the importance of transactional due diligence targeted at anti-corruption risks. In April 2009, Latin Node pleaded guilty in the U.S. to making improper payments to government officials in Honduras and Yemen. The payments were identified by eLandia after the closing of its acquisition of Latin Node. Latin Node agreed to pay a \$2 million criminal fine in installments over a three-year period. In July 2009, a federal jury in New York convicted American investor Frederic Bourke of charges that he conspired to violate the Foreign Corrupt Practices Act (FCPA) in connection with a corrupt scheme to privatize the State Oil Company of the Azerbaijan Republic (SOCAR). In addition to evidence that Mr. Bourke had actual knowledge of the scheme, the DOJ pursued a theory of willful blindness by Mr. Bourke: that as an experienced investor, he should have known of the scheme and consciously avoided doing so. The DOJ used the absence of well-conceived due diligence as part of its evidence that Mr. Bourke had the knowledge of a corrupt scheme necessary to support a criminal charge and conviction.

Goals of Due Diligence. Post-transaction regulatory risk is most frequently analyzed through theories of successor liability, under which regulators would argue that an acquiror could be held liable for pre-closing actions of the target that are either known or unknown at the time of closing but are only resolved, by settlement or government enforcement action, after closing. In addition, although the theory has not been pursued in the anti-corruption context, regulators could take the position that revenues from an asset acquired by improper means (such as a contract obtained through a bribe or manipulation of privatization procedures) remain tainted and are subject to civil disgorgement or criminal forfeiture.

In this context, pre-closing or offering diligence has several goals. First and foremost, it is to find out whether there are questionable payments, improper accounting entries, or controls weaknesses that could create liability. Second, due diligence has a prophylactic aspect: an entity should satisfy itself that it took prudent and reasonable steps to identify potential risks. If none are discovered pre-transaction, but an issue arises later, the due diligence procedures will form the basis for arguments that no liability should be imposed after the transaction is completed. Third, with an expectation of "day one" compliance following an acquisition or investment, an acquiror should use pre-closing diligence to identify steps to be taken after closing to minimize forward-looking risks.

Risk Profile. Established practices, 2008 guidance from the DOJ, and the DOJ theory in the Bourke case confirm that a risk-based approach to due diligence, and focus on high risk sales, relationships and government interactions, is appropriate. *See* DOJ FCPA Opinion Procedure Release 08-02 (June 13, 2008) ("the Halliburton Opinion Release").¹ The corporate structure of the parties, their industry, relevant geographies, and compliance history all impact the risk profile. In a multinational transaction, the parties likely will want to focus their anti-corruption scrutiny and perform a heightened level of due diligence on affiliates and subsidiaries operating in countries where corruption risk is high. If one of the parties to the transaction is already under investigation or has recently been under investigation for possible anti-corruption violations, the transaction has a higher perceived risk and authorities will expect heightened attention to corruption due diligence. In environments that have not had a robust history of anti-corruption enforcement, a key economic issue may be assessing whether enforcing anti-corruption policies following a transaction will affect the existing business model or operations. An acquiror also should assess whether imposing necessary compliance programs will result in a loss of sales, licenses, or similarly valuable assets.

Additional high risk areas include:

- A target whose revenues rely primarily on large government contracts.
- Highly regulated businesses such as those that require regular inspection approvals from local health and safety authorities.
- Industries that depend heavily on product instruction and demonstration, with sales accomplished through regular educational seminars or conferences.
- A target with relationships with third-party agents.
- **Due Diligence Procedures.** Anti-corruption due diligence usually can be performed, at least initially, in tandem with standard economic and financial due diligence requests. As confirmed by the Halliburton Opinion Release, anti-corruption due diligence should target potentially high risk areas of a business. Although these risk areas may vary by industry and geography, they frequently can be explored by requests for information regarding the following:
 - An entity's controls environment: policies, procedures, employee training, audit environment, and whistleblower issues.
 - The nature and scope of an entity's government sales and the history of significant government contracts or tenders. Risks include improper commissions, side agreements, cash payments, and kickbacks.
 - An entity's important regulatory relationships, such as key licenses, permits, and other approvals. Due diligence in that context would focus on employees who interact with these regulators, and whether there are any fees, expediting payments, gifts, or other benefits to government inspectors.
 - Travel, gifts, entertainment, educational, or promotional expenses used by an entity to provide benefits to government officials. Diligence in this area would include examining expense records, inspection or training trips, and conference attendee lists and expenses.
 - An entity's relationships with distributors, sales agents, consultants, and other third parties as well as joint venture, teaming or consortium arrangements. In this context, it is important to assess whether an entity: (1) has processes for review and approval of contracts with third parties; (2) requires consulting agreements to be in writing and to include appropriate compliance clauses; and (3) authorizes payments only after services have been documented and only to appropriate recipient bank accounts. Evidence of third-party due diligence inquiries and representations should be maintained in the company's files. The acquiror also should determine whether the target has contractual rights to audit third-party contractors and the right to terminate an agent or business partner in the event of a breach of anti-corruption laws or representations.

Once initial background information is obtained in these areas, further diligence can be performed by obtaining and reviewing documentary and electronic files and general ledger accounts. This information can be supplemented by interviews of relevant management personnel.

Timing of Anti-Corruption Due Diligence Procedures.

In addition to discussions regarding scope, parties to a transaction may negotiate the timing of anti-corruption due diligence, whether it will be completed prior to

¹ Halliburton sought the Opinion Release in connection with its possible acquisition of Expro International Group PLC, explaining that it had limited pre-closing access to the Expro, a United Kingdom-based oil and gas products and services company, because the transaction was being conducted through an auction. Although (pursuant to DOJ regulation) the FCPA Opinion Release may not be relied upon by any party other than Halliburton, it nevertheless provides helpful guidance for transactional FCPA due diligence, both pre-closing and post-closing.

signing a definitive agreement, or whether all or some of the inquiry will be performed after signing but before closing. Post-signing due diligence may be preferable when an initial agreement is reached quickly or in an auction or other competitive process, but it also has risks. If an issue is identified after signing, it may lead to re-negotiation of price, public disclosures, or voluntary disclosures to government authorities, thereby delaying or ultimately preventing closing.

To maximize the possibility that post-signing due diligence will be confidential and orderly, it is often prudent to have a written work plan delineating precisely what the review will consist of, who will conduct it, and what access each party will have to the findings. When drafting such a plan, consideration should be given to privilege issues, confidentiality, and each party's rights and duties regarding disclosure of information that is gathered in the diligence.

The Halliburton Opinion Release describes a possible procedure for post-closing due diligence – and voluntary disclosures – in the context of an auction transaction where pre-closing due diligence was not feasible. The contemplated target operated in a number of jurisdictions with a high corruption perception index, and at the time Halliburton was under active DOJ and SEC investigation for its activities in many of these same regions. In this circumstance, Halliburton proposed, and the DOJ endorsed, a 180-day post-closing period to conduct staged post-acquisition due diligence, and to self-report any corruption, accounting, or controls violations identified.

Response to a Potential Anti-Corruption Violation.

The actions taken once an issue is identified can profoundly affect the government's response and can determine whether a transaction can be completed. Specifically, an entity should consider: (1) discipline of employees and officers who made or authorized improper payments; (2) specific remedial steps to

improve controls, policies, and procedures in the areas related to the issue identified; (3) disclosure of the issue to relevant local authorities or entities as may be required by law; (4) possible disclosure to national authorities in the home jurisdictions of the entities involved. To the extent that there is an existing anti-corruption investigation of any of the entities involved in the transaction, the circumstances of that investigation should be taken into account in assessing government and public disclosure obligations arising from the identification of an issue in transactional due diligence.

"Day One" Compliance. Even if no problematic issues are identified in pre-transaction due diligence, there is an expectation that appropriate controls will be introduced on "day one" following closing of a transaction. In the merger context, and to the extent permitted by antitrust laws, parties to a transaction may want to begin outlining a post-closing compliance policy framework and organizational structure immediately after signing a letter of intent. Key elements of such a program include: (1) written policies that address governing anti-corruption laws; (2) revised reporting structures; (3) compliance resources for sales personnel and other relevant employees; (4) training; and (5) an audit function to review compliance. The Halliburton Opinion Release emphasizes that post-closing compliance also should focus review and enhancement of controls over third-party relationships. It may be appropriate, for example, to execute contract amendments or even new contracts to incorporate appropriate anti-corruption representations and warranties and audit rights.

Conclusion. In light of recent enforcement activity, anti-corruption due diligence should be considered as an important component of an acquisition or investment plan, and should be well documented and carefully executed.