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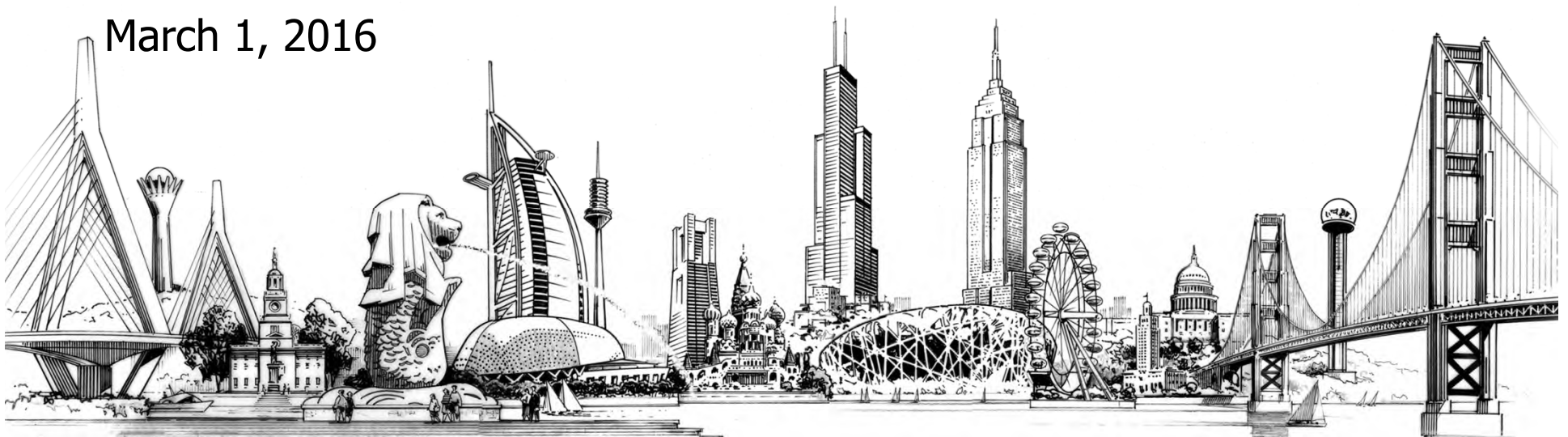
CONDUCTING RISK-BASED FCPA DUE DILIGENCE IN M&A TRANSACTIONS

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Conducting Risk-Based FCPA Due Diligence in M&A Transactions

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DOJ/SEC Guidance

According to the DOJ/SEC, to avoid successor liability a purchaser must:

1. Conduct thorough preacquisition risk-based FCPA due diligence on the target.
2. Ensure that, postacquisition, the acquiring company's policies and procedures are applied to the target as quickly as practicable.
3. Train personnel (including, in some cases, agents and business partners) at the target on anticorruption laws and company policies.
4. Conduct an FCPA-specific audit during post-closing integration.
 - DOJ and SEC report that, in a number of instances, they have declined to bring enforcement actions against companies that have voluntarily disclosed and remediated conduct in the M&A context.

DOJ/SEC Guidance

Another suggestion of the DOJ is to use the Opinion Release procedure for M&A transactions. While there are several opinion releases in the M&A context, this process is both time consuming and may, according to the DOJ, contain more stringent requirements that may be necessary in all circumstances.

It is important to emphasize that while, by following the above advice, you may be able to avoid or minimize successor liability for the acquiring company, you will not avoid the liability for any past FCPA violations of the target company being acquired, and such liability can materially adversely affect the value of the proposed investment.

The 2012 joint DOJ/SEC FCPA Guide contains several practical examples to illustrate to illustrate their enforcement approach in the M&A context.

DOJ/SEC Guidance

“[N]o due diligence is perfect and . . . society benefits when companies with strong compliance programs acquire and improve companies with weak ones. At the same time, however, neither the liability for corruption—nor the harms caused by it—is eliminated when one company acquires another.”

“A Resource Guide to the U.S. Foreign Corrupt Practices Act”

by the Criminal Division of the DOJ and the Enforcement Division of the SEC

Industry Practice

September 2015 KPMG Survey of Global Companies Reports:

60% of respondents indicated that mergers and acquisitions are part of their growth strategy.

69% of US- and UK-listed entities include antibribery considerations in preacquisition due diligence.

55% of non-US/UK-listed entities do so.

54% of unlisted entities do so.

“Anti-Bribery and Corruption: Rising to the Challenge in the Age of Globalization,” KPMG International,
<https://assets.kpmg.com/content/dam/kpmg/pdf/2015/09/anti-bribery-corruption-2015.pdf>

RISK-BASED DUE DILIGENCE

- The FCPA Guide states: "A company that does not perform adequate FCPA diligence prior to a merger or acquisition may face both legal and business risks."
- However, there is very little guidance on what level of risk-based FCPA due diligence is required for a particular target.
- There is a fundamental difference between responding to a governmental enforcement action or pursuing an internal investigation, on the one hand, and performing M&A due diligence on the other.

RISK-BASED DUE DILIGENCE

- Governmental enforcement cases and internal investigations focus on discovered conduct that may be a violation. The work required includes reviewing and producing many documents and interviewing many witnesses. This process can take many months and even years.
- In contrast, risk-based FCPA due diligence attempts to identify the FCPA risk areas of a target in a relatively short period of time – often with limited access to critical documents and personnel.

RISK-BASED DUE DILIGENCE

The risk assessment should focus on the following:

1. The nature of the target's business and reputation in the market.
2. The industry and the countries in which the target operates.
3. The extent to which the target utilizes third parties in dealing with customers and regulators.
4. The extent to which the target interacts with government officials or has government customers.
5. The strength of the target's existing compliance program and internal controls.

PRACTICAL APPROACHES

1. Form an FCPA due diligence team, which should include both transactional lawyers and members of the compliance and finance departments, and possibly outside consultants depending upon the extent and scope of international operations.
2. Determine the amount of time, scope of FCPA due diligence and allocation of responsibilities. Transactional lawyers focus on the high-level areas of risk given the target's business model and international operations; the compliance department focuses on the target's compliance program and past incidents; and the finance department focuses on books and records and accounting controls, including any material weaknesses in internal controls.

PRACTICAL APPROACHES

3. Because information concerning FCPA compliance issues is rarely included in publicly available materials or in a data room, it is critical to conduct early on an interview of the target's compliance and business personnel to understand FCPA risk.
4. If enforcement cases or internal investigations are discovered or disclosed, it may be necessary to bring in outside litigation counsel to assess the potential impact on the target and its business/value pursuant to a common interest agreement to prevent waiver of the privilege.

PRACTICAL APPROACHES

5. One of the largest challenges in conducting due diligence is determining when a desk-top review or interview of target personnel may be insufficient and when certain potentially high-risk transactions should be audited in more detail. This kind of audit can be very time consuming and fraud and corruption issues are often difficult to detect without a full investigation.

Transactions Review through review of:

- High-risk G/L accounts (permitting, consulting fees, entertainment expenses)
- Vendor and third-party payments
- Petty cash transactions
- Cash advances

Consideration of:

- Highest transaction amounts
- Round dollar/currency amounts
- Transactions with duplicate dates
- Transactions with duplicate document/invoice numbers
- G/L descriptions

PRACTICAL APPROACHES

6. Another challenging area is discovering potential books and records and accounting control violations of the target's foreign subsidiaries.
 - Note that, to the extent there is a limited opportunity to conduct preacquisition FCPA due diligence, it is essential to conduct more in-depth postacquisition FCPA due diligence to eliminate ongoing FCPA compliance problems. DOJ Opinion Release 08-02 addresses this issue.
 - The FCPA Guide also stresses the importance of postacquisition compliance integration, rendering it critical that the acquiring company itself have an effective compliance program.

KEY RISK AREAS

Key risk areas to focus on include the following:

1. Is the target in a high-risk industry?
 - For example, the target or its competitors are in an industry of particular focus for US governmental authorities and there have been enforcement cases involving the target or its competitors.
 - Industry examples: Oil and Gas, Telecommunications, Medical Devices, Pharmaceuticals
 - Diligence Goal: Understand the regulatory environment and enforcement patterns to plan diligence resources and effort.

KEY RISK AREAS

2. Does the target operate in a high-risk country?
 - For example, the target is located in or operates in a country that has a reputation for corruption.
 - Locations of concern include countries such as China, Brazil, Argentina, India, Indonesia, The Philippines, and other countries with poor scores on the Transparency International Corruption Perceptions Index.
 - Locations of concern can also vary depending on the target's industry.
 - Diligence Goal: Understand the target's business model, including its ethics culture, compliance structure, and methods for operating in challenging ethical environments.

KEY RISK AREAS

3. Does the target have extensive international sales, foreign subsidiaries or many points of contact with foreign government officials (or politically exposed persons)?
 - For example:
 - The target has an Asian subsidiary focusing on a market consisting of many government customers.
 - The Asian subsidiary is managed by a foreign national who has significant family contacts in the government.
 - The target has multiple business-related licenses issued by various levels of government.
 - Diligence Goal: Understand and apply the level of diligence effort necessary to reasonably assess risk.

KEY RISK AREAS

4. Does the target rely on the use of third-party intermediaries to make sales or to handle government relations? Are you able to easily identify the target's third parties in its records and accounting systems?
 - For example:
 - The target relies heavily on third-party intermediaries with success fees or other incentive compensation.
 - The target has third parties involved in handling government relations activities, including obtaining critical permits/regulatory approvals.
 - Contracts with third parties do not have FCPA clauses, or they have limited provisions, and there is little evidence that third parties have been trained in the FCPA.
 - Diligence Goal: Identify and evaluate high-risk intermediary activities and the target's preengagement diligence on and continuing oversight of third parties.

KEY RISK AREAS

5. Does the target rely on business gifts and entertainment, including travel, as well as charitable and political contributions as part of its sales and marketing?
 - For example:
 - The target’s sales representatives have a history of being reimbursed for significant sales and marketing expenses without appropriate documentation.
 - Many customers have been reimbursed for travel.
 - Significant charitable or political contributions have been made in other countries (potentially for purposes of market access).
 - Diligence Goal: Assess (i) whether the business has been built on a foundation of corrupt activities, (ii) the strength of the target’s accounting controls, and (iii) the cultural risks inherent in the business.

KEY RISK AREAS

6. How strong is the target's compliance program and culture, including the tone at the top? If the target has no program, how strong are its accounting controls and business processes?
 - For example:
 - The target has an underfunded compliance program which appears to be a document taken off the shelf and not customized to its business.
 - The target has a newly adopted compliance program.
 - Training and auditing are infrequent and the tone at the top is focused on the achievement of sales objectives.
 - There is little or no use of a company reporting "hotline" or other reporting mechanisms.
 - There are no compliance cases or sanctions imposed on anyone for violating the company's code of conduct.
 - Diligence Goal: Understand the target's ethics culture.

KEY RISK AREAS

7. How cooperative is the target with the diligence process?
 - For example:
 - The target is slow to produce compliance documents.
 - The target has numerous documents produced in the local language only.
 - Internal experts are uninformed concerning key diligence areas.
 - Diligence Goals: Determine whether a lack of cooperation reflects compliance weaknesses that require enhanced diligence inquiries in one or more areas. Consider engaging FCPA diligence specialists for targeted diligence efforts.

KEY RISK AREAS

8. Does the target have an ongoing internal or government FCPA investigation, or have bribery concerns been otherwise reported?
 - For example:
 - The target has disclosed the existence of a government investigation or subpoena.
 - The target has produced compliance hotline reports reflecting bribery allegations.
 - Diligence Goal: Understand nature of the allegations, exposure, employee and third-party involvement, affected business units, and current control environment.

USE OF DUE DILIGENCE

Once the risk-based FCPA due diligence is concluded, you need to assess the effect of what you have found on the overall transaction. Options include:

- (a) proceeding as planned or renegotiating to account for risks,
- (b) delaying closing until further due diligence is done or active cases/investigations are resolved and then reassessing or renegotiating, or
- (c) walking away.

USE OF DUE DILIGENCE

Questions to consider include:

1. How much of the target's revenue stream could be affected?
2. How many key employees, intermediaries, or customers may be affected or need to be retrained or terminated?
3. Is the target's business model/culture so different that it will be difficult to integrate it into your compliance program without the business being materially affected?
4. How much uncertainty is there concerning whether you have had sufficient time to assess compliance risks or to resolve known compliance issues and quantify associated costs and liability?
5. Can identified risks be addressed through contractual provisions or revaluation? Or are they so serious that they should be resolved prior to closing?

FCPA Contractual Provisions

Sample FCPA antibribery representation and warranty:

Neither the Issuer [, the Guarantor,] nor any of [its/their respective] subsidiaries or affiliates, nor any director, officer, agent, employee or other person associated with or acting on behalf of the Issuer [, the Guarantor,] or any of [its/their respective] subsidiaries or affiliates, has (i) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expense relating to political activity, (ii) made any direct or indirect unlawful payment to any foreign or domestic government official or employee, to any employee or agent of a private entity with which [ISSUER GROUP] does or seeks to do business (a "Private Sector Counterparty") or to foreign or domestic political parties or campaigns from corporate funds, (iii) violated or is in violation of any provision of any applicable law or regulation implementing the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions or any applicable provision of the US Foreign Corrupt Practices Act of 1977, as amended, the UK Bribery Act 2010, or any other similar law of any other jurisdiction in which the [ISSUER GROUP] operates its business, including, in each case, the rules and regulations thereunder, (iv) taken, is currently taking or will take any action in furtherance of an offer, payment, gift or anything else of value, directly or indirectly, to any person while knowing that all or some portion of the money or value will be offered, given or promised to anyone to improperly influence official action, to obtain or retain business or otherwise to secure any improper advantage or (v) otherwise made any bribe, rebate, payoff, influence payment, unlawful kickback or other unlawful payment; the Issuer [, the Guarantor] and each of [its/their respective] subsidiaries has instituted and has maintained, and will continue to maintain, policies and procedures reasonably designed to promote and achieve compliance with the laws referred to in (iii) above and with this representation and warranty; and none of the Issuer [or the Guarantor] will directly or indirectly use the proceeds of the Notes or lend, contribute or otherwise make available such proceeds to any subsidiary, affiliate, joint venture partner or other person or entity for the purpose of financing or facilitating any activity that would violate the laws and regulations referred to in (iii) above.

FCPA Contractual Provisions

Sample FCPA books and records and accounting controls representation and warranty:

The Issuer [, the Guarantor] and [its/their respective] subsidiaries maintain a system of internal accounting controls sufficient to provide reasonable assurance that (i) transactions are executed in accordance with management's general or specific authorization, (ii) transactions are recorded as necessary to permit preparation of the Issuer's/Guarantor's [consolidated] financial statements in conformity with the accounting rules and standards applicable in [ISSUER JURISDICTION] [and for the purposes of IFRS] and to maintain accountability for assets, (iii) access to assets is permitted only in accordance with management's general or specific authorization, (iv) the risk of fraud is combated, (v) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences and (vi) [the Issuer has not/neither the Issuer [, the Guarantor] nor any of [its/their respective] subsidiaries has] experienced any material difficulties with regard to (i) to (v) above. Except as described in the Prospectus, since the end of the Issuer's/Guarantor's most recent audited fiscal year, there has been (I) no material weakness in the Issuer's [, the Guarantor's] or [its/their respective] subsidiaries' internal control over financial reporting (whether or not remediated) and (II) no change in the Issuer's [, the Guarantor's] or [its/their respective] subsidiaries' internal control over financial reporting has materially affected, or is reasonably likely to materially affect, the Issuer's [, the Guarantor's] or [its/their respective] subsidiaries' internal control over financial reporting.

Considerations for Sellers

Sellers should consider the following with respect to FCPA issues:

1. Prepare due diligence for buyers by doing a self-assessment of ongoing compliance issues, including hotline complaints, internal investigations, or external enforcement cases.
2. Prepare any required disclosure information and determine at what time and in what manner to disclose it to buyers.
3. Be prepared for a discussion with buyers concerning the potential materiality of FCPA compliance issues in terms of purchase price adjustments in public deals where representations, warranties and indemnities do not survive the closing or special escrows in private deals where they do.
4. Be prepared for a requirement by buyers that the FCPA issues be disclosed to enforcement authorities as a condition of closing.

Considerations for Buyers

Buyers should consider the following with respect to FCPA issues:

1. Prepare due diligence plan and allow for adequate time where possible; do not let the sellers delay disclosure until the 11th hour.
2. Adjust the due diligence plan and resources depending upon what is learned.
3. Discuss with sellers and buyers' own counsel potential materiality of FCPA compliance issues and level of uncertainty.
4. Consider FCPA representation and warranty insurance products.
5. Consider adequacy of proposed special escrows in private deals where issues have been identified.
6. Consider whether forcing disclosure to enforcement authorities will lead to timely resolution of FCPA issues before closing.
7. Prepare preacquisition the postacquisition FCPA compliance integration plan.
8. If the target is a public company, consider SEC disclosure obligations and potential issues relating to material weaknesses in internal controls.

Cautionary Case: LatiNode

Florida-based company eLandia discovered the target's history of bribery in its post-acquisition diligence on target LatiNode.

- Violations were disclosed to the DOJ by eLandia within three months of discovery.
- No enforcement action was taken against eLandia.
- Target LatiNode pled guilty to violating the FCPA and paid the statutory maximum \$2 million fine.
- Four executives from LatiNode were convicted of violating the FCPA, and three received prison terms.
- The investment was essentially written off because of enforcement actions.

Biography



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Margaret Gatti represents US and non-US companies, universities, and financial institutions in matters involving economic sanctions, export controls under the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR), customs and import regulations, free trade agreements, antiboycott regulations (EAR and IRS), anticorruption laws (FCPA and UKBA), anti-money laundering legislation, international commercial sales terms (INCOTERMS), international e-commerce, and Bureau of Economic Analysis (BEA) reporting, as well as national security issues.

As part of her export control and national security practices, Ms. Gatti also is involved in filings before the Committee on Foreign Investment in the United States (CFIUS), and has represented both foreign buyers and investors in and domestic sellers of U.S. businesses in reviews by that Agency. She has substantial experience in negotiating and mitigating Foreign Ownership, Control, and Influence (FOCI) issues that may be presented as conditions to clearance of a proposed transaction.

She also advises on internal investigations, enforcement cases, and dispute resolution proceedings relating to her transactional and regulatory practice.

Biography



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Louis Ramos is a former federal prosecutor and in-house lawyer whose practice focuses on white collar litigation, government and internal investigations, and compliance counseling. Lou's experience includes leading investigations and counseling clients on matters involving issues of anticorruption, antibribery, antikickback, the Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, and good research and manufacturing practices. He has led investigations in the United States and around the world, including Latin America, China, Japan, Korea, Canada, Europe, the Middle East, India, and Pakistan.

Prior to joining Morgan Lewis, Lou served as an Assistant General Counsel in the Compliance Division at Pfizer for four years. At Pfizer, Lou managed a team of lawyers responsible for international compliance matters. Before joining Pfizer's team, he was a partner focusing on white collar matters at another international law firm. Lou primarily represented pharmaceutical, healthcare, and financial services clients in complex government and internal investigations involving alleged violations of the FCPA, the False Claims Act, off-label promotion, antikickback statutes, money laundering, bank fraud, and good research and manufacturing practices.

Biography



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Carl Valenstein focuses his practice on domestic and international corporate and securities matters, mergers and acquisitions, project development, and transactional finance. He counsels extensively in the life science, telecom/electronics, and maritime industries, and he has worked broadly in Latin America, the Caribbean, Europe, Africa, Asia and the Middle East.

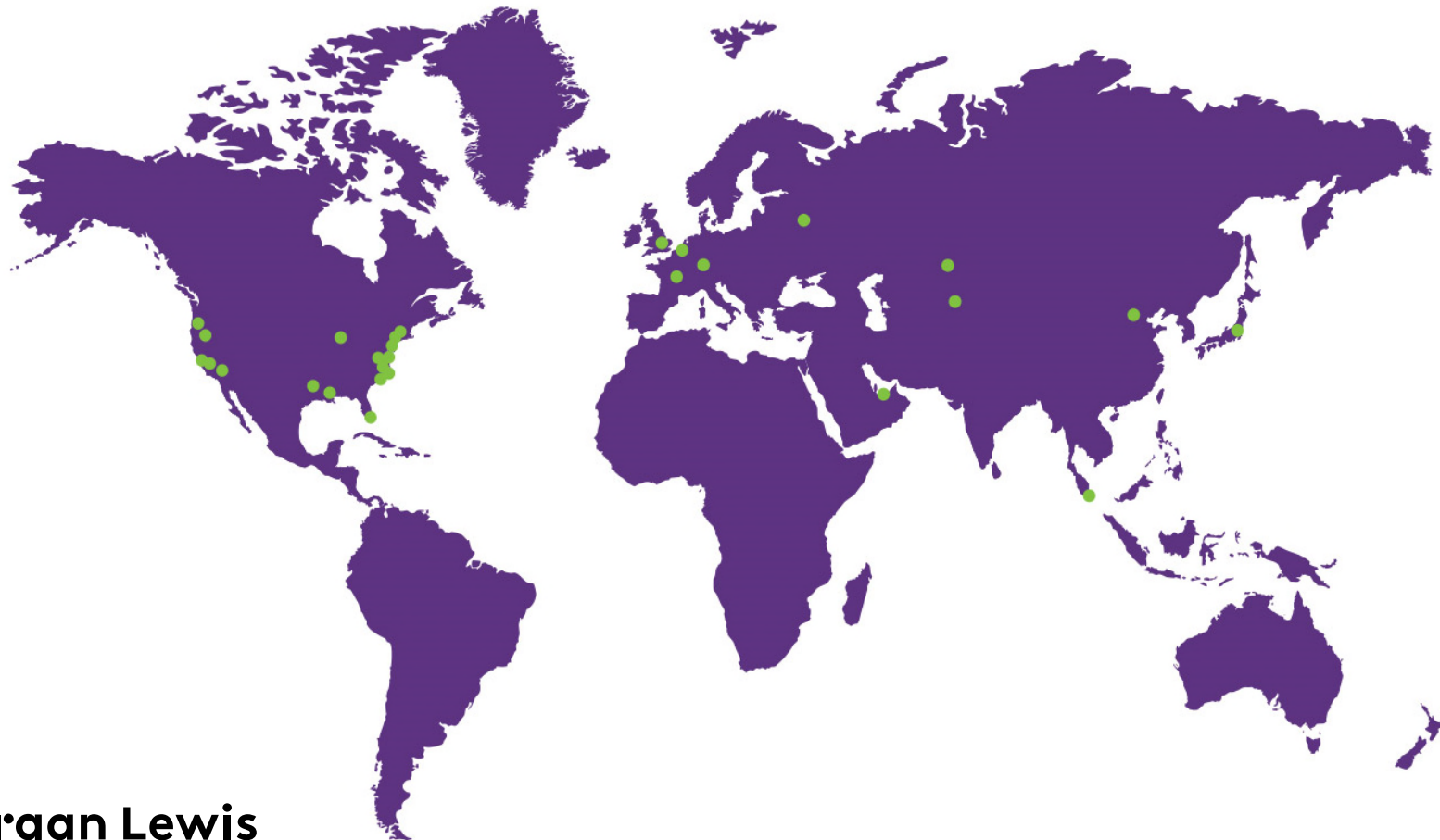
Carl advises clients on international risk management, including compliance with the foreign investment review process (Exon-Florio/CFIUS), export control and sanctions, anti-money laundering, anti-boycott, and anticorruption (FCPA) laws and regulations. He also advises on internal investigations, enforcement cases, and dispute resolution proceedings relating to his transactional and regulatory practice.

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