What You Need to Know About the FCPA Before You Do Your Next Deal

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An important aspect of any acquisition process involves the identification and quantification of the target company’s liabilities. In addition to traditional focuses of due diligence investigation, acquirers must focus on the target company’s compliance with the Foreign Corrupt Practices Act (the “FCPA”) as a potential source of liability due to the increasingly aggressive enforcement of the FCPA by the U.S. Department of Justice (the “DOJ”) and the Securities and Exchange Commission (the “SEC”).

Although enacted in 1977, against the backdrop of the Watergate scandal and the related congressional investigations, the FCPA gained prominence in mergers and acquisitions circles with the failed 2004 merger between Lockheed Martin and Titan Corp. Titan had been under investigation for alleged FCPA violations in the West African nation of Benin by the DOJ, and its failure to settle the probe scuttled a transaction that was at the time valued at close to $2 billion. Recent years have seen further life breathed into the FCPA with a dramatic uptick in enforcement actions brought by the DOJ and the SEC. While the DOJ brought only a handful of actions under the FCPA in the first 25 years after its enactment (including none in 2000), it brought approximately three dozen enforcement actions in 2010 alone. The SEC, which brought nine enforcement actions between 1978 and 2000, commenced fifteen in 2010. That year also saw the SEC form a specialized FCPA Unit, while the DOJ has created partnerships with an FBI squad dedicated to FCPA investigations and U.S. Attorney’s offices around the country in addition to training a number of dedicated FCPA prosecutors. Provisions of the Dodd-Frank Act of 2010, furthermore,
have incentivized whistleblowers by permitting the SEC to award them between ten to thirty percent of the total recovery arising from independent reports of securities law violations, including FCPA violations, that result in monetary sanctions in excess of $1 million.

The reach of the FCPA also continues to extend to the most prominent corporate names: Wal-Mart, for example, reported in December 2011 that it had disclosed an ongoing internal investigation of its FCPA compliance to the DOJ and the SEC. In doing so, the company joined a list of approximately eighty public companies believed to be subject to ongoing FCPA-related investigations, but it also received front-page billing in an April 2012 New York Times article featuring allegations that executives at both Wal-Mart and its Mexican subsidiary had ignored or actively sought to conceal internal inquiries into potential FCPA violations. The 2005 internal investigation concerned millions of dollars in suspect payments by the company’s Mexican operations to accelerate store openings. The ongoing matter, which has generated investigations by the DOJ, SEC and Mexican authorities, comes as the DOJ and SEC continue to hold consultative meetings in advance of an anticipated guidance release.

Notwithstanding the importance to a potential acquirer of understanding a target company’s compliance with the FCPA where the target company has operations outside of the United States, practical limitations in the negotiation and execution of M&A and joint venture transactions make it difficult to perfectly assess FCPA non-compliance issues. A target company, especially in a competitive situation with multiple potential acquirers, is not likely to permit an acquirer to have the level of access to its books, records and personnel necessary for such an assessment. Furthermore, due to the speed at which M&A and joint venture transactions are negotiated and executed, an acquirer would typically not have sufficient time to conduct such an assessment even if it was provided with the required access. However, while FCPA risks cannot be entirely eliminated, an acquirer can minimize such risks by:

- Understanding the broad applicability of the FCPA and the various liabilities and consequences that arise out of violations of it;
- Developing a due diligence strategy that is tailored to pick up FCPA concerns amidst broader transaction constraints;
- Formulating an informed initial (and subsequent) decision “to go or not go” ahead with the transaction;
- Considering strategies to minimize risk or halt non-compliant behavior, including alternate transaction structures and contractual provisions; and
- Undertaking post-closing actions to ensure compliance by the acquired entity.

The FCPA

Background

The FCPA contains both an anti-bribery and a record-keeping and internal controls provision. Both provisions apply to issuers who have securities listed on a United States national securities exchange or are otherwise subject to the SEC reporting requirements (including foreign private issuers). The anti-bribery provision also covers domestic concerns (individuals who are U.S. citizens, nationals and residents, and companies that have their principal place of business in the U.S. or which are organized under laws of the U.S.) and foreign persons committing violations in U.S. territory.

The anti-bribery provision of the FCPA prohibits issuers and other covered entities from making corrupt payments to foreign officials for the purpose of obtaining or retaining business or directing business to any person. The anti-bribery provision requires the person making the payment to have the intent to (1) influence any act of a foreign official, (2) induce a foreign official to act in violation of its lawful duty, (3) secure any improper advantage or (4) induce a foreign official to use its influence with a foreign government to influence any act of such government. In addition to
corrupt payments made to foreign officials themselves, the FCPA also prohibits payments to third parties where the issuer or other covered person knows (which knowledge can include willful blindness) that all or a portion of such payment will be offered or given to a foreign official for the purpose of obtaining or retaining business or directing business to any person.14 “Corrupt payments” themselves are interpreted broadly to include “anything of value,” with no statutory minimum, and a “foreign official” includes not only employees or officers of foreign government agencies, but also members of political parties and employees of international organizations such as the United Nations and World Bank.15 A limited number of exceptions are available for the anti-bribery provisions, including for “reasonable and bona fide expenditures,” payments that are lawful under the laws of the foreign official’s country and payments for routine governmental actions by foreign officials, such as obtaining permits, licenses or other official documents to qualify a person to do business in a foreign country.16

The record-keeping and internal controls provision requires every issuer to maintain (1) books, records and accounts in reasonable detail that accurately and fairly reflect the transactions and dispositions of the assets of the issuer and (2) a system of internal accounting controls sufficient to provide reasonable assurances that transactions are executed in accordance with management’s authorization and recorded as necessary to prepare financial statements.17 The standard for finding a violation of the record-keeping and internal controls provision is not materiality but reasonableness, such that the improper recordation of a transaction could be immaterial from a federal securities law perspective but could still be a violation of the FCPA (if the improper recordation was not reasonable).18 This is important to keep in mind as violations of the record-keeping and internal controls provision involve much higher monetary penalties19 than the anti-bribery provisions and are typically easier for the DOJ and SEC to prove, given their relatively straightforward elements as compared with those of the anti-bribery provision.

**Director and Officer Liability**

The uptick in FCPA enforcement has predictably included a surge in actions against individuals, many of which concern executives who allegedly authorized illicit payments.20 However, in 2009, the SEC brought an enforcement action against certain officers of Nature’s Sunshine Products for record-keeping and internal control FCPA violations based on their failure to adequately supervise company personnel in devising and maintaining a system of internal controls sufficient to have provided reasonable assurance that products sold in a foreign country were adequately monitored. The action was brought even though these officers did not have actual knowledge of the underlying violations. This enforcement action has important ramifications for directors and officers of an acquirer in the event that a target company has FCPA issues that continue following the closing of the transaction, as they may be held responsible for such violations under this control person test.

**Liabilities and Consequences for Violations**

There are different consequences for violations of the anti-bribery and record-keeping and internal controls provisions. There are generally no criminal consequences for record-keeping and internal control violations in the absence of a person knowingly circumventing or failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account. The general statutory civil and criminal penalties for FCPA violations include:

- For corporations: for each anti-bribery violation, the greater of $2 million or twice the gain (or loss) the participant gained (or avoided), and $25 million for each record-keeping and internal controls violation;21
- For individuals: five years in prison with a maximum $250,000 fine for anti-bribery violations, 20 years in prison with a maximum $5 million fine for books and records violations;22 and
• Other penalties such as debarment from federal government contracts, imposition of an independent monitor and other compliance obligations.

M&A Deal Planning and Considerations

An acquirer who is interested in acquiring a target company (or its assets) with non-U.S. operations should formulate a due diligence plan designed to determine if any FCPA issues exist. When coupled with the commitment by an acquirer to implement an FCPA compliance program, a properly designed due diligence plan is not only effective in assessing the potential FCPA risk of the target company but also in minimizing successor liability risk with the DOJ and SEC.

Initial Assessment

Once a potential target company with a non-U.S. nexus is identified, an acquirer should conduct an initial review to assess the probability of FCPA non-compliance on the part of the target. This initial assessment is important in order to develop an effective due diligence plan and should be completed prior to the commencement of the expensive and time-consuming diligence process. An initial assessment can be done on the basis of publicly available information (including background checks on the key employees and directors) and involves identifying certain warning signs or “red flags” which generally exist with companies found to have FCPA violations. While the presence of a red flag does not in and of itself indicate an FCPA violation, it should invite further investigation.

Warning signs that should be readily identifiable include (1) the presence of operations in countries with a reputation for corruption, such as emerging markets or countries that rank highly on Transparency International’s Corruption Perceptions Index, (2) a reputation for corruption or other non-compliance with law or past accusations of the same against the target company and its officers, directors or employees, (3) certain industries, such as healthcare, energy and defense, which may invite particular regulatory scrutiny due to their concentration in emerging markets or reliance of their business on foreign regulators and (4) the use of third party contractors or intermediaries, as many SEC/DOJ enforcement cases involve third-party contractors (often engaged on the direction of local government or state-owned enterprises).

A sample of other common red flags includes:

- Involvement of government (or ex-government) officials, directly or through family or other relationships;
- Dependency on government contracts/licenses/relationships;
- Offers of “special arrangements” with decision makers;
- Payment or commission not commensurate with services offered;
- Lack of documentation or detail with respect to operations and financial records;
- Requests that payments be made to a third party or in another country;
- Use of offshore, tax haven bank accounts;
- Resistance to providing requested information or representations;
- Use of intermediaries for no apparent reason; and
- Requests that the transaction be kept confidential.

Scope of Due Diligence

Following the completion of the initial assessment, a tailored but thorough diligence plan should be created. Certain areas commonly covered in FCPA due diligence are the use of intermediaries and similar third parties, litigation, regulatory, tax or customs investigations or inquiries, material contracts or bids, gifts and hospitality spend, political and charitable contributions and the employment of foreign officials.
or their relatives. The scope of the due diligence exercise, however, should be refined or expanded as red flags are identified. As a starting point, buyers should ask a number of threshold questions, including but not limited to:

- Does the target have an FCPA compliance policy in place?
- How well does the target maintain books and records?
- Does the target have an internal reporting mechanism in place?
- Does the target conduct FCPA training?
- Does the target use third parties as foreign business representatives?
- Is the target company or any of its competitors suspected of or under investigation for corruption?
- Have there been, or are there any ongoing, internal investigations related to corruption?

**Due Diligence Tools and Documentation**

There are many service providers who will conduct background checks on officers, directors and the target company, including Kroll Associates, Control Risks Group and Veracity Worldwide. However, an acquirer needs to take care to work with these service providers not only on the “check the box” items (such as criminal offenses) but also on the employment, family and educational backgrounds of officers and directors and potential relationships or links to government officials and agencies. If red flags have been identified with the financial statements or accounting records of the target company, such as inflows or outflows with no specific details or purposes, an acquirer should consider engaging a forensic accountant to examine the books and records of the target company. It should be noted that in most transactions there will not be sufficient time for this type of review, nor will most target companies be willing to allow such an examination to be conducted. An acquirer should also provide a target company with a written questionnaire for senior management to complete or answer that is focused on corruption issues and interview these senior officials to the extent possible. The interviews can serve the additional purpose of permitting an acquirer to gain a better understanding of the corporate culture of the target company. Information or answers provided by senior management in the questionnaires or interviews should be independently verified if possible. U.S. embassies and consulates can also be a fertile source of information on the target’s reputation and operations in jurisdictions around the world.

**To Go Or Not To Go**

Once the initial assessment and due diligence investigation of the target company have been completed, the acquirer will need to determine whether to pursue the transaction or abandon it. The calculus of whether to proceed with a transaction should take into account the effectiveness of the target company’s internal controls and procedures, as not all FCPA issues may be identified in due diligence and an acquirer may need to remedy any issues post-closing. If indicia of corruption at the target company are discovered during due diligence, an acquirer needs to answer a series of threshold questions. The first question is whether the target company can continue as a successful business absent the corruption. If the corruption is required as an on-going aspect of the business, the acquirer may determine that the acquisition does not make commercial sense. However, if the activity in question is isolated to a single person or activity which is not integral to the success of the operation, there may be contractual solutions to allocate any risk or liability between the acquirer and target company. If the corruption is not critical to the success of the business, the acquirer must still determine if the transaction is worth the challenges and risks in light of the corruption issue, including the time, effort and cost required to remedy and halt the offending conduct.
Minimizing FCPA Risk Once the Deal Is Underway

Transaction Structuring Alternatives

As is the case with other liabilities of a target company, the structure of the transaction may allow the potential acquirer to be selective in avoiding the assumption of FCPA liabilities. Where a merger or stock purchase of an entire company would leave a successor company or acquirer exposed to liability for past violations of the target (as generally all liabilities of the target company are assumed in those transaction structures), an asset purchase may allow an acquirer to carve out untainted assets and employees while allowing the target to continue as a going concern and retain liability for any historical corruption and record-keeping liabilities. However, this approach has limitations on its usefulness, depending on the amount and significance of assets purchased from the target company. It is well-settled under general corporate law principles that an acquirer of all or a substantial portion of a target company’s assets may not avoid assuming the target company’s liabilities, on the theory that the transaction is a de facto merger and the acquirer is a mere continuation of the seller. Factors that are relevant to this determination include continuity of the selling enterprise (such as of management, personnel, offices and business operations), express or implied assumption of the seller’s liabilities, a consolidation or merger of the acquirer and the seller and whether the transaction is a fraudulent attempt to circumvent the seller’s obligations. An acquirer should therefore undertake due diligence efforts and obtain contractual provisions as if it was engaging in a complete acquisition of the target, and pursue other defensive measures such as specifying the liabilities that transfer with the particular assets and obtaining indemnities in the asset purchase agreement.

Contractual Provisions

While representations and warranties in the transaction agreement can serve as a defensive tool for buyers and help show due care (which does not insulate an acquirer against FCPA enforcement actions but may be a mitigating consideration), they are most effective when they (1) are drafted broadly while closely tracking statutory language, (2) explicitly reference the FCPA, (3) include specific representations on particular areas of concern, such as charitable donations or interactions with government officials and (4) are joined with closing conditions and other provisions that allow the buyer to terminate the agreement or avoid an obligation to close in the event of any inaccuracy thereof. Typical contractual representations by the target include:

- Conduct of business activities in accordance with all applicable anti-corruption laws and the FCPA;
- No violation of FCPA resulting from use of proceeds from business activities and from the transaction;
- Absence of corrupt payments;
- No governmental officials or relatives hold key positions in or own any securities of the target of any of its subsidiaries; and
- Books and records are accurate and complete.

FCPA representations and warranties can also serve as the basis for post-closing indemnification that compensates the acquirer for losses incurred as a result of a breach of those representations. If the acquirer becomes aware of a potential FCPA issue during due diligence and determines to proceed with the acquisition without notifying government authorities, a stand-alone indemnification provision for losses suffered in connection with the potential issue may be appropriate. A purchaser may also require the FCPA issue to be corrected or addressed prior to closing through a closing condition. The closing condition should require not only the complete remediation of the issue but also the implementation of additional controls and procedures to prevent future issues. If the transaction is one in which the target company is being acquired in its entirety, it may be appropriate for the acquirer to require the selling stockholders to set aside a portion of the purchase...
price in an escrow to support their FCPA indemnification obligations.

**Disclosure and Resolution of Problems**

If an acquirer discovers an FCPA violation at the target company during due diligence, reporting the violations is also an option, although efforts to do so can be hampered by confidentiality agreements or a target’s uncooperativeness. In a number of transactions, buyers have imposed settlement with the SEC and DOJ as a pre-closing condition, and successfully closed their acquisitions with no successor liability after robust cooperation with the agencies and resolution of the charges (which can nevertheless carry heavy penalties and continuing requirements). In its 2007 acquisition of Armor Holdings, Inc., BAE Systems plc was able to escape successor liability for violations that included payments to a U.N. procurement official to award U.N. contracts to the target’s subsidiary. Although both the SEC and DOJ levied civil monetary penalties, the DOJ noted that the illicit activity occurred before the transaction and credited Armor’s “self-investigation and cooperation” and “extensive remedial efforts undertaken. . .before and after Armor’s acquisition.” The non-prosecution agreement also required Armor to, among other things, develop (and integrate with its acquirer’s existing) due diligence protocols, review processes, internal controls and compliance systems.

**Post-Closing Diligence and Remediation**

A buyer may choose to proceed with a transaction where neither due diligence efforts nor contractual provisions are able to provide it with a satisfactory level of assurance regarding the target company’s compliance with the FCPA. In such situations, the SEC and the DOJ may provide relief through an opinion release or similar exemptive action. The best-known example of this is the DOJ’s Opinion Release No. 08-02, which it issued in 2008 for an acquisition by Halliburton. Halliburton sought relief from the DOJ in connection with a proposed acquisition of a United Kingdom target company where Halliburton had insufficient time and inadequate access to the target company’s information to conduct an appropriate FCPA due diligence investigation due to United Kingdom legal restrictions inherent in the bidding process. The DOJ agreed not to take an enforcement action against Halliburton for (1) the acquisition itself, (2) any pre-acquisition unlawful conduct by the target company disclosed to the DOJ within 180 days of the closing and (3) any post-acquisition conduct by the target company disclosed to the DOJ within 180 days of the closing and which did not continue beyond that period. In connection with the grant of this relief, Halliburton agreed to present a detailed FCPA due diligence work plan to the DOJ within ten business days of the closing, and to report the results of its due diligence investigation to the DOJ on high-, medium- and lowest-risk issues within 90, 120 and 180 days after closing, respectively. While its application is limited to the particular Halliburton transaction, the Halliburton release is nevertheless a useful guide of post-closing actions an acquirer can undertake in order to consummate a transaction and still protect itself from FCPA liability in transactions where pre-closing diligence is limited. Acquirers considering pursuing exemptive relief similar to the Halliburton release should also note Halliburton was required to take a number of post-closing actions in order to obtain relief from the DOJ, which certain acquirers may decide are too onerous. However, the DOJ entered into a Deferred Prosecution Agreement with Johnson & Johnson in January 2011 where it specified conditions for a post-closing due diligence under which certain of the more burdensome compliance requirements from Halliburton were eased.

**Post-Closing Integration and Monitoring**

Following closing, the acquirer should integrate its FCPA policy, procedures and accounting controls with the former target’s existing programs as soon as possible. This may entail conducting FCPA training for newly-acquired officers and employees, particularly those in high-risk areas.
such as management, sales, accounting and financial controls. It may also be necessary to monitor the former target’s FCPA compliance by conducting random reviews of books and records, disciplining or terminating rogue employees and otherwise ensuring that representations and warranties made in the transaction agreements are being followed.

**Conclusion**

With the increasing number of enforcement actions being pursued by the SEC and the DOJ and the potential for director and officer liability, it has become critical for acquirers to assess potential FCPA risks of target companies before agreeing to make the acquisition. While timing constraints and information asymmetries make it impossible for any acquirer to have perfect information, an acquirer can design a due diligence process and negotiate contractual provisions to minimize the risk and protect against potential FCPA risks after closing.

**NOTES**

10. U.S.C.A. § 78dd-1 (anti-bribery); § 78m (books and records); §§ 78c(a)(8) (definition of “issuer”).
11. 15 U.S.C.A. § 78dd-2 (domestic concerns); § 78dd-3(a) (foreign persons).
15. U.S.C.A. § 78dd-1(c)(2) (for issuers); § 78dd-2(c)(2) (for domestic concerns); § 78dd-3(c)(2) (for foreign persons) (“Reasonable and bona fide expenditures [are generally] travel and lodging expenses, incurred by or on behalf of a foreign official . . . directly related to the promotion, demonstration or explanation of products or services, or the execution or performance of a contract with a foreign government or agency thereof.”).
17. 15 U.S.C.A. § 78m(b).
22. Id.


28. Id.


30. Halliburton was obliged to retain external counsel and third-party consultants (including forensic accountants), review e-mail and financial and accounting records and immediately undertake a number of compliance steps (which included an agreement to enter into completely new contracts containing FCPA and anti-corruption provisions with third parties continuing their relationship with the target).