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The Uncertainty of Conducting Pre-acquisition FCPA Due Diligence in Mergers and Acquisitions

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INTRODUCTION

Given the extensive costs of pre-acquisition Foreign Corrupt Practices Act (FCPA) due diligence and the need to stay competitive in foreign markets, U.S. companies should not conduct expansive pre-acquisition FCPA due diligence while pursuing acquisitions of companies not subject to the FCPA. Congress enacted the FCPA in 1977 to combat bribery and corruption of foreign officials by U.S. companies and agents of those companies.[1] In recent years, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have increased their investigations and the amount of enforcement actions taking place. [2] The FCPA affects Mergers and Acquisitions (M&A) by allowing the DOJ and SEC to impose successor liability for companies who have acquired past violators of the FCPA[3] and for U.S. based companies who acquire a foreign company that regularly engages in corrupt business decisions. This paper focuses on pre-acquisition FCPA due diligence in regards to acquisitions of target companies not subject to the FCPA. Part I discusses the circumstances when FCPA due diligence may not be possible, and I argue that companies find it impractical and inefficient. The current U.S. FCPA anti-corruption laws and FCPA Guidance, make the process of conducting pre-acquisition FCPA due diligence inefficient with the uncertainty of prosecution by the DOJ and SEC. Part II argues that FCPA due diligence prior to foreign acquisitions will not result in smaller fine amounts and discusses when the DOJ will hold acquiring companies liable for successor liability. Part III analyzes the alternative methods to protect companies who forego pre-acquisition FCPA due diligence, and I will argue that these measures will provide the same level of protection without the extensive costs. Finally, in part IV, I will discuss the ethical considerations of companies foregoing FCPA due diligence and how that decision affects the lawyers' ethical obligations involved in the acquisition.

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1. Foreign Corrupt Practices Act, 15 U.S.C.A. § 78dd-2.

2. *See, e.g.*, Richard L., Cassin *With Alstom, Three French Companies Are Now in the FCPA Top Ten*, THE FCPA BLOG (Dec. 23, 2014, 9:45 AM), http://www.fcpablog.com/blog/2014/12/23/with-alstom-three-french-companies-are-now-in-the-fcpa-top-t.html.

3. For a discussion of the requirements of successor liability in the mergers and acquisition context, see Carolyn Lindsey, *More Than You Bargained For: Successor Liability under the U.S. Foreign Corrupt Practices Act*, 35 OHIO N.U. L. REV. 959, 965–68 (2009).

1. When Pre-acquisition FCPA Due Diligence is Impractical

While the importance of due diligence cannot be understated when acquiring a company, in many circumstances, companies may not have the time to conduct a thorough investigation, and the FCPA due diligence costs can make the deal unattractive.[4] This issue was exemplified in a takeover bid by Halliburton of Expro back in 2008, where, due to U.K. laws, Halliburton was not allowed to conduct full due diligence. [5] Companies are then left at a competitive disadvantage with foreign businesses that are not under the scope of the FCPA, and this may lead an American corporation to forego a competitive bid for a foreign business.

The FCPA is largely based on voluntary self-disclosures, which means a self-regulating industry of anti-corruption,[6] thus leaving companies at odds of self-disclosure or not. Companies who have discovered an FCPA violation that has occurred in the past may find it more economical to eradicate the issues internally and forego self-disclosure to the DOJ. In light of this, a company may find it better to conduct less FCPA due diligence prior to a foreign acquisition. The DOJ and SEC have indicated they will consider self-disclosure in high regard to determine enforcement of potential violations.[7] An empirical study has shown no significance in relation to self-reporting and amount in fines and sanctions.[8] Given the conflicting statement and data, the issue of self-reporting has become a decision between ethical obligations and business decisions. These competing ideologies then become a cost-benefit analysis as to what circumstances advance the company's best interest.[9] With all of this uncertainty, the DOJ and SEC will need to provide clearer guidance of

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4. *See*, Adam Prestidge, *Avoiding FCPA Surprises: Safe Harbor From Successor Liability in Cross-Border Mergers and Acquisitions*, 55 WM. & MARY L. REV. 305, 314–15 (2013).

5. *See, e.g.*, Richard L. Cassin, *Halliburton, Expro and Umbrellastream Star In Opinion Procedure Release 08-02*, THE FCPA BLOG (Jun. 25, 2008, 6:18 AM), http://www.fcpablog.com/blog/2008/6/25/halliburton-expro-and-umbrellastream-star-in-opinion-procedu.html.

6. *See* Comm. On Int'l Bus. Transactions, *The FCPA and It's Impact on International Business Transactions – Should Anything Be Done to Minimize the Consequences of the U.S.'s Unique Position on Combating Offshore Corruption?*, 2011 N.Y.C. BAR ASS'N 7-8, *available at* http://www2.nycbar.org/pdf/report/uploads/FCPAImpactonInternationalBusinessTransactions.pdf [hereinafter *N.Y.C. Bar Report*].

7. *See* CRIMINAL DIV. OF THE U.S. DEP'T OF JUSTICE & ENFORCEMENT DIV. OF THE U.S. SEC. & EXCH. COMM'N, FCPA: A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICE ACT 54 (2012), *available at* http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf [hereinafter FCPA GUIDANCE].

8. *See* Stephen J. Choi & Kevin E. Davis, *Foreign Affairs and Enforcement of the Foreign Corrupt Practices Act* 17–22 (NYU Law & Economics, Research Paper No. 12-15, 2014), *available at* http://ssrn.com/abstract=2116487 [hereinafter *Foreign Affairs and Enforcement*].

9. For an article that discusses the potential benefits and consequences from FCPA counsel, see Laura Fraedrich & Jamie A. Schafer, *What is in it For Me: How Recent Developments in FCPA Enforcement Affect the Voluntary Disclosure Calculus*, GLOBAL TRADE AND CUSTOMS JOURNAL, Vol.8, Issue 9, (2013), available at http://www.kirkland.com/siteFiles/Publications/Global%20Trade%20and%20Customs%20Journal%20(Fraedrich%20byline)%20Sept.%202013.pdf.

their enforcement actions, so U.S. companies will not need to compete ethical obligations and business decisions.

The costs associated with FCPA due diligence may also accrue if the investigation turns up some potential red flags that require further post-closing investigation. While the SEC and DOJ released a joint guidance to give companies information to avoid or mitigate liability, the enforcement actions are still at the discretion of the enforcement agencies and the costs of compliance in the investigation have been in the multi-millions of dollars.[10] This leaves companies with a general idea of what can be expected, but given the large amounts in fines handed down, as mentioned above, acquisitions of companies with high-risk potential are likely to slow down. In M&A transactions in which a target company does business in high-risk potential countries, FCPA due diligence becomes more costly due to the available resources and the information that may be accessible.[11] If a potential violation is found during that due diligence process, it will then lead to either further costly investigations with the DOJ and SEC being notified of the disclosure,[12] or the company can choose not to disclose and risk discovery. The ethical obligations of choosing not to disclose are discussed further below.

2. Pre-acquisition FCPA Due Diligence and Successor Liability

The level of pre-acquisition FCPA due diligence will have no correlative effect on the enforcement action of target companies not subject to the FCPA pre-acquisition. Other more effective compliance and anti-corruption policies incorporated post-acquisition will allow U.S. companies to stay competitive by keeping due diligence costs lower.[13] Since the release of the FCPA Guidance issued by the DOJ and SEC, not every foreign company that is acquired will subject a buying company to successor liability for past FCPA violations.[14] As the FCPA Guidance states "successor liability does not, however, create liability where none existed before".[15]

The DOJ further summarized its position in FCPA Opinion Release 14-02 that the past violations of an acquired company not within the jurisdiction of the FCPA will not be prosecuted against the acquiring company.[16] The DOJ will not prosecute past violations not subject to the FCPA, but the DOJ was unwilling to give any advice or opinions as to

10. *See* FCPA GUIDANCE, *supra* note 7, at 28, 74–75.
11. See Prestidge, *supra* note 4, at 314–15.
12. *Id*.
13. *See N.Y.C. Bar Report*, *supra* note 6, at 9.
14. *See* FCPA GUIDANCE, supra note 7, at 28.
15. *Id*.
16. *See* U.S. Dep't of Justice, *Foreign Corrupt Practices Act Opinion Procedure Release 14-02*, (Nov. 7, 2014) http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2014/11/14/14-02.pdf [hereinafter *FCPA Opinion Release 14-02*].

the effects of post-acquisition violations during the integration process.[17] The example of pre-acquisition due diligence of the requestor in that opinion saw no beneficial benefit from the extensive money spent in conducting pre-acquisition due diligence.[18] This is an area of FCPA enforcement that the DOJ and SEC have yet to provide concrete guidance for companies to avoid prosecution, leaving companies to proceed with the uncertainty of discretionary prosecution by the two enforcement agencies.

3. Foregoing Pre-acquisition FCPA Due Diligence

As a solution to the extensive costs of pre-acquisition FCPA due diligence, U.S. companies should not conduct extensive pre-acquisition FCPA due diligence when acquiring foreign companies not previously subject to the FCPA. Companies should rather focus on post-acquisition integration and structuring the transaction with deal devices for protection from liability.

A. FCPA Prosecution and Integration Measures

While many foreign countries have made initiatives to implement anti-corruption laws, U.S. companies are still at a competitive disadvantage in foreign acquisitions of companies not subject to the FCPA or stringent corruption laws.[19] Since successor liability will not be prosecuted under these facts, a U.S. company that foregoes an extensive and time consuming pre-acquisition FCPA due diligence investigation will be able to implement anti-corruption compliance measures to avoid future violations in the acquired company.

The DOJ has looked to nine factors when determining whether to bring an enforcement action against a company, the biggest factor being the nature and seriousness of the offense.[20] The company should shield itself from successor liability with an effective corporate compliance program that is implemented post-acquisition. The acquiring company should implement the company procedures with the acquired company starting from day one of the integration process to avoid any future violations. This solution will provide U.S. companies to compete better with

17. *Id*.

18. For an illustration of the amount of money the requestor spent for the FCPA due diligence efforts to uncover past violations, *see* Prestidge, *supra* note 4.

19. *See N.Y.C. Bar Report*, *supra* note 6, at 8–14.

20. The 9 factors listed for consideration of prosecuting a corporation for FCPA violations: "1. The nature and seriousness of the offense; 2. The pervasiveness of wrongdoing within the corporation; 3. The corporation's history of similar misconduct; 4. The corporation's timely and voluntary disclosure of wrongdoing and willingness to cooperate; 5. The existence and effectiveness of the corporation's pre-existing compliance program; 6. The corporation's remedial actions; 7. Collateral consequences; 8. The adequacy of prosecution of individuals responsible for the corporation's malfeasance; and 9. The adequacy of remedies such as civil or regulatory enforcement actions." *See* FCPA GUIDANCE, *supra* note 7, at 53. And for a study on the sanctions imposed under the FCPA, see *Foreign Affairs and Enforcement*, *supra* note 8.

foreign competitors who are not in the jurisdiction of the FCPA in foreign M&A transactions. The compliance programs initiated post-acquisition will need to be extensive in high-risk areas of the acquired company to avoid potential FCPA violations.[21] U.S. companies and those in countries with similar anti-corruption laws will most likely be at a competitive disadvantage, due to necessary increases in costs, compared to their counterpart countries with no such laws. By foregoing pre-acquisition due diligence under the circumstances just enunciated, U.S. companies engaged in foreign M&A transactions can help limit total costs and potentially garner more business opportunities.

B. Structuring the Deal for Adequate Protection from Liability

Companies should, in turn, use other acquisition deal devices to circumvent the risks associated with FCPA violations that may come from past practices of the acquired company. Per custom, acquiring companies will hire consultants to help the integration process of doing business abroad.[22] Hiring a consultant to handle the integration process of the acquired company and establishing FCPA compliance guidelines will help ease the cost of an extensive pre-acquisition due diligence investigation. With the correct consultant, a company can structure representations and warranties that will provide assurance that the consultant acts in compliance with the FCPA and, as Kerschberg further states, a contractual indemnification provision can help ease potential FCPA violations.[23]

A company should also protect the value of the deal with a comprehensive representations and warranties section specifically applicable to the FCPA with the sellers of the foreign company. The starting point of assessing the proper representations and warranties for the FCPA will be considered based on the risk profile of the target company.[24] While negotiating representations and warranties, the extensive nature of these deal devices will take into account the risk profile, where factors such as the industry, geographic location, government contracts, and whether the existing subsidiaries of the target company are in known high risk countries. These factors are likely to affect the amount of representations and warranties needed.[25] In addition to these FCPA representations and war-

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21. See *N.Y.C. Bar Report*, *supra* note 6, at 10.

22. *See* Ben Kerschberg, *Protecting Your Corporation Against FCPA Liability in Mergers and Acquisitions*, FORBES (March 28, 2011, 9:50 AM), http://www.forbes.com/sites/benkerschberg/2011/03/28/protecting-your-corporation-against-fcpa-liability-in-mergers-acquisitions/ [hereinafter *Protecting Your Corporation*].

23. *Id*.

24. *See*, Gary DiBianco, *"Anti-Corruption Due Diligence in Corporate Transactions: Implementing a Risk-Based Approach"*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (February 2013), https://www.skadden.com/insights/anti-corruption-due-diligence-corporate-transactions-implementing-risk-based-approach-anti-

25. For a more in depth analysis of risk factors affecting a company's risk profile, *supra* note 20

ranties, the acquiring company should negotiate for an indemnification provision that covers any past contracts obtained through FCPA violations or ongoing FCPA violations.

4. Ethical Considerations of Non-disclosure of FCPA Violations

A more critical analysis involves the ethical responsibilities of a lawyer involved with the company and his obligations to the bar. If the non-disclosure of the potential FCPA violation would be considered an ongoing fraud, the lawyer would have to disclose it under the rules of professional conduct.[26] These rules would present issues for the lawyer, and his knowledge may prevent the corporation from not disclosing the violation or retaining the lawyer's services. Given the large implications involved, this may be an issue where the lawyer must recuse himself if the non-disclosure rises to the level where it would be a breach of his ethical duties.[27] Failure to conduct thorough FCPA due diligence involves in-house counsel to forego their duties to their client.[28]

Lawyers will be forced to balance business decisions and their ethical duties to the client when deciding whether to forego pre-acquisition FCPA due diligence. However, given the above considerations as to how a company can protect itself from future FCPA violations when acquiring companies who were not previously subject to the FCPA can also assure lawyers that their ethical obligations to the client are being satisfied. As one of the nine factors the DOJ looks to in deciding to prosecute[29] implementing an effective compliance and ethics program in the company may help alleviate pre-acquisition costs while maintaining the lawyers ethical obligations to his client.[30]

CONCLUSION

With growing trends in global anti-corruption laws and increased enforcement trends under the FCPA, regulatory guidance will need to be certain.

The growing costs of FCPA compliance and acquisition transaction costs will affect the current due diligence landscape. While due diligence as a whole is a process that should never be foregone, under the current FCPA Guidance and successor liability, the representation and warranties combined with indemnification provisions will prove to be a competitive way to negotiate with foreign companies. This article only argues

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26. *See* Colo. Rules of Prof'l Conduct 1.2, 1.6, 1.13 (2015).
27. *Id*.
28. Under the Colorado Rules of Professional Conduct, Rule 1.13, the duty is to the corporation and the decision to not undergo FCPA due diligence could come into question as misrepresentation of the client by the lawyer for putting the client at risk of potential legal liability. *See* Colo. Rules of Prof'l Conduct 1.13, cmt. 3.
29. *See* note 20, *supra*.
30. *See* Colo. Rules of Prof'l Conduct 1.13 (2015).

that there are circumstances when companies should provide less pre-acquisition FCPA due diligence and does not conclude that all due diligence of a target company should be foregone.

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