Non-Prosecution Agreements in the FCPA: Impacting the Viability of Mergers One DOJ Opinion Letter at a Time

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NON-PROSECUTION AGREEMENTS IN THE FCPA:
IMPACTING THE VIABILITY OF MERGERS ONE DOJ
OPINION LETTER AT A TIME

I. INTRODUCTION

In recent years, the Department of Justice (DOJ) and the Securities Exchange Commission (SEC) have increased the prevalence of prosecutions for Foreign Corrupt Practices Act (FCPA) violations by 60%, costing companies an average of $1.5 billion in fines in 2014 alone.¹ As companies become more wary of the economic impact of FCPA violations, they have begun to seek alternative solutions to compliance in the mergers and acquisitions context. In response, the DOJ has implemented the use of Non-Prosecution Agreements (NPA) with extensive compliance requirements that have ultimately forced companies to concede to FCPA violations.

This Article evaluates the impact of these NPA on mergers and acquisitions by delving into their dark side through an analysis of the agreement entered into by Halliburton in relation to their acquisition of Expro. This Article suggests that the use of these agreements affects the viability of mergers by increasing the target’s potential liability, increasing the acquiring company’s costs, implementing exhaustive disclosure requirements, and leaving a vast amount of operational discretion to the DOJ. As a solution, this Article suggests that NPA are not in the best interests of the vast majority of companies and can be avoided by performing thorough FCPA due diligence and risk assessment prior to merging or acquiring a target company. Should they be the only alternative to a viable merger, this Article examines the importance of contractual protections in order to avoid the pitfalls of an NPA by allowing companies to negotiate acquisition costs that reflect the costs of remedial measures for FCPA violations before bearing the burden of self-reporting.

This Article is comprised of six sections. Section II touches briefly upon the history of the FCPA and the procedure of opinion letter requests. Section III explains the highly publicized NPA entered into by Halliburton in exchange for liability protection pertaining to its acquisition of Expro. Section IV highlights the many risks and drawbacks of NPA in the FCPA context. Section V describes the need for companies to avoid entering into these agreements, while recognizing that in certain circumstances these agreements can be made without harsh impacts if the

¹. Recent Trends and Patterns in FCPA Enforcement, Shearman & Sterling LLP (January 2015), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/01/Recent-Trends-and-Patterns-only-LT-010515.pdf
company does thorough FCPA related due diligence and drafts contractual protections. Lastly, Section VI concludes that companies should be wary of these agreements because of their substantial cost, the requirement of an admission of guilt, and the ability of the DOJ to impose restrictive measures.

II. THE FOREIGN CORRUPT PRACTICES ACT AND NON-PROSECUTION AGREEMENTS

In response to a myriad of bribery payments revealed through studies done by the SEC (which uncovered that 20% of Fortune 500 companies had paid out over $300 million in bribery payments to government officials), Congress enacted the Foreign Corrupt Practices Act in 1977. This legislative act was meant to filter out dishonest business practices and prevent economic disadvantages in the marketplace pertaining to bribery payments.

The FCPA consists of two main provisions: anti-bribery and accounting provisions. The anti-bribery provision prevents any exchange or promise of exchange of money, gifts or anything of economic value to foreign officials in order to obtain a business advantage. The accounting provisions require that a company keep accurate books and consistent internal controls to ensure that all monetary payments are recorded properly.

As FCPA violations became more visible, so too did the amount of prosecutions and open investigations into companies. As a result of the increase in litigation, the DOJ allowed companies to enter into NPAs. These agreements ultimately provided a path of legal recourse that allowed a company to resolve criminal disputes without being subject to a lengthy litigation. Congress intended the original form of NPAs to aid prosecutors in the juvenile crime context. Soon they were expanded to cover corporate prosecution efforts, and since 1992 their use has increased drastically and encompassed the intricacies of FCPA violations.

Presently, the use of NPAs has evolved in the FCPA context through the DOJ in the form of opinion letters. In order for a company to be offered an NPA they must first submit a request for an opinion letter. These requests have specific requirements as laid out by § 80 of the FCPA Opinion Procedure. Presently, these requests must include detailed

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4. Id.
6. Id. at 149.
and specific information submitted in writing, it cannot be a hypothetical situation and should be made prior to the commitment to proceed with the transaction, and lastly it must be accompanied by all relevant and material information (true and accurate disclosure). In response to these requests, the DOJ may issue an opinion letter detailing strict requirements for the company to follow in order to avoid liability for FCPA violations, thus creating a complex protection mechanism that corporations in fear of prosecution have sought extensively.

III. HALLIBURTON AND EXPRO: A LEADING EXAMPLE OF THE DARK SIDE OF NON-PROSECUTION AGREEMENTS

The opinion letter issued in relation to Halliburton’s acquisition of Expro is perhaps the most widely publicized. The NPA detailed within the letter stands as an exemplar of how impactful an agreement with DOJ can truly be by detailing extensive due diligence requirements, reporting requirements, stringent deadlines, and forcing an admittance of liability to be extended to all Expro officials found to be in violation of the FCPA. Ultimately, these requirements stood as a substantial threat causing permanent damage which ended all further negotiation. The NPA now stands as an adequate warning to others of the intricate issues involved when attempting to employ the protections of the DOJ.

In 2008, Halliburton sought the aid of the DOJ in relation to their attempted takeover of Expro. Halliburton is a well-known oil company who was engaged in a hostile bidding war with Umbrellastream (a foreign investment group) for the purchase of Expro. Expro provides well-flow management solutions to the oil and gas industry. As Halliburton attempted to conduct due diligence to uncover any FCPA indiscretions involving Expro, they ran into an obstacle. U.K legal restrictions prevented Halliburton from being able to perform adequate due diligence and Halliburton was limited to the scarce information Expro was willing to provide. Due to Expro’s lack of desire to enter into negotiations with Halliburton, Expro did not provide Halliburton with any further information. Furthermore, Expro did not have to agree to entertain an offer by Halliburton that was subject to any condition not already imposed by Umbrellastream, thus causing a concern that potential FCPA violations would never be discovered until after the acquisition. After completing the opinion letter process, the DOJ agreed to relinquish Halliburton from liability if specific requirements were met post-acquisition. These requirements included Halliburton (1) meeting with the DOJ upon closing

9. Id. at 2
10. Id. at 2
and disclosing all information relating to potential FCPA violations committed by Expro; (2) presenting to the DOJ—within ten days of closing—a comprehensive due diligence plan that incorporates three phases (high risk, medium risk, low risk) and mandates periodic reports due at ninety days, 120 days, and 180 days; (3) signing new contracts with third parties that included FCPA oriented warranties and representations; (4) requiring employees enter into new employment contracts and FCPA training procedures; and (5) implementing Halliburton’s code of conduct into all Expro operations.11

As the news and content of the DOJ NPA reached the ears of Expro officials, the viability of the takeover subsequently soured. In a move meant to provide protection to the company, its employees, and its assets Expro signed the deal with Umbrellastream.12 Approximately one month after the publication of the DOJ opinion letter, Expro had fled into the arms of another entity showing that the threat of liability and the fear of extensive corporate change based off of the requirements of the DOJ were enough to quash the viability of a merger already fraught with tension.

IV. THE TRUE COST OF NON-PROSECUTION AGREEMENTS

Since the first corporate NPA in 1992, companies have been rushing to resolve FCPA violations with these agreements at higher rates than ever before.13 These NPAs certainly solve a short term problem (the looming violation waiting to be prosecuted); however, they do significantly more damage to the company in the long-run. As noted by author Allen R. Brooks, “While these agreements provide several short-term benefits, the long-term consequences of these agreements perpetuate ambiguities surrounding enforcement of the FCPA. Thus, the federal government’s enforcement policy locks corporations into a cycle of regulatory uncertainty, resulting in increasing costs of doing business abroad”.14

So what risks do companies actually face when entering into an NPA with strict guidelines from the DOJ? As shown by Halliburton there are several, including a risk of foiling the merger in its entirety as the target rushes to seek an alternative acquirer, a substantial increase in business operational and remedial measures costs, extensive due diligence and reporting requirements, and a vast amount of DOJ discretion allowing them to revoke and prosecute violations as they see fit. As such,

11. Id. at 2
12. Id. at 1
14. Id. at 138
the inherent risks of entering into an NPA can prove to be more detrimental than the FCPA violations that may exist, causing the viability of a merger to be substantially impacted and potentially terminated in its entirety.

A. The End of a Deal

First and foremost, the looming threat of a merger or acquisition being quashed by the content of an NPA should be enough to make any company reevaluate. The Halliburton and Expro fiasco attests that this fear is well founded in reality. Portions of the deal required Halliburton to handover incriminating evidence of all Expro employees or officials involved in any corrupt payments.\(^{15}\) Halliburton would have essentially been acting as the government’s informant, turning over data that would ensure the government’s success in litigation. If Halliburton was to turn over Expro to the DOJ, the company could face fines of up to $2 million dollars per violation and individual liability of up to $100,000 per violation with five years’ imprisonment per violation for individuals involved.\(^{16}\)

As is to be reasonably expected, this type of agreement instills fear within target companies causing them to seek an acquirer elsewhere. The reality of the penalties for a single violation for any employee action weighs as a heavy liability. By ensuring that an acquiring company acts as an investigator and informant, the DOJ has created a system where their cases are essentially built for them with undeniable information that would not be as easily obtained or accessible without the cooperation of an informant. The DOJ is ensuring its ability to make a statement regarding FCPA violations, dragging entire companies into the limelight to be subjected to reputational scrutiny and heavy prosecution, and it can do so through the implementation of NPAs.

Although companies should not be involved with corrupt payments to foreign officials, the DOJ does not take into consideration that a large company with multiple subsidiaries, operating in high risk areas in high risk industries (such as Expro) do not have the ability to monitor every employee’s actions at every point in time.\(^{17}\) Such extensive efforts are not practical and facing immediate prosecution because Halliburton’s role as an informant causes mergers like this to instantly implode. Companies then seek investment opportunities elsewhere, perhaps at lower

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premiums as Expro did with Umbrellastream, causing an impact on the economic viability of foreign mergers and acquisitions.

B. Exorbitant Costs Associated with Non-Prosecution Agreements

There are several costs associated with NPAs that should be considered by acquiring companies seeking to make a deal in obtaining target companies. First, acquiring companies are subject to DOJ monetary penalties regardless of whether the company enters into an NPA. These agreements are not meant to preclude the company from financial liability for the violations committed, thus an acquiring company must take into consideration whether the fine alone will have a negative impact on the future operations or the success of the merged or acquired entity. Fines imposed on companies entering into NPA’s average $15.1 million.\(^{18}\) Although the fines a company is subjecting themselves to are reportedly less than the ones they would face should litigation conclude, there are more strings attached with hidden costs to fines assessed in relation to an NPA than there are if the outcome of litigation does not favor the company.

It is important that an acquiring company recognize that these mandatory fines are merely the beginning of the expenses that will be incurred. Corporate compliance programs, federal monitoring, periodic reporting, financial audits, employee training, and contract revisions all increase the financial burden placed on a company seeking the protection of the DOJ.\(^{19}\)

In the case of Halliburton, the DOJ required three phases of due diligence with periodic reporting that would have essentially required Halliburton to be working around the clock analyzing volumes of data and paperwork. The due diligence team alone would have been an extremely costly endeavor, not to mention the DOJ’s requirement that Halliburton retain external counsel, third party consultants, forensic accountants, cover all locations of operation, and review all relevant records down to emails.\(^{20}\) This circumstance required exorbitant costs be paid for records and document review, for attorneys to re-write contracts (both third party and employee), for compliance programs to be implemented and disseminated through employee training programs, for financial accountants, for internal investigations etc. The list of costs would continue indefinitely until all aspects of the DOJ requirements were fulfilled, causing a poten-

:\(^{18}\) Ralph F. Hall, Understanding and Complying with Compliance Agreements, in PUNISH CORPORATE CRIME: LEGAL PENALTIES FOR CRIMINAL AND REGULATORY VIOLATIONS 155, 159 (Oxford Univ. Press 2009).


tially devastating effect on the financial viability of the newly acquired company.

Similar to Halliburton, the NPA entered into by cosmetic powerhouse, Avon, also became a costly warning to other companies seeking similar protection. Avon has incurred investigation costs of over $170 million as it attempts to uncover bribery payments, corrupt travel and entertainment expenses, and inadequate internal controls. Examples like Avon and Halliburton show that there is much to be lost with mandated internal investigation procedures and vast due diligence.

Due diligence, reporting, and investigation costs are not the only costs an acquiring company would incur with an NPA. The reputational costs, loss of sales, and remedial measures costs seem almost unquantifiable at the outset of entering into an NPA. Once compliance measures are implemented, a company may discover multiple terminated sales contracts that were the fruits of bribery. The negotiated pricing in these sales contracts and the payments of bribes in order to retain them may not be able to be reproduced legally, leaving the company without any mechanism to pursue sales growth in certain areas or to continue business. Additionally, loss of sales and an admission of foul play to the DOJ in order to enter into NPAs creates an increase in risk that future contracts will be lost, that reputational damage will be incurred preventing other contracts from being entered into, and shareholder value will ultimately decrease.

Perhaps the most costly of all endeavors taken on by a company seeking protection from the DOJ is the cost of remedial measures. As was the case in Halliburton, the DOJ will often require that a company implement a code of conduct, engage in extensive employee training sessions, and create a compliance program. As per their suggestion, compliance programs should consist of the following hallmarks such as management oversight, a code of conduct and specific FCPA policies, training and continuing advice, and incentives and disciplinary measures in order for them to be considered beneficial. Employee compliance is not the only remedial measure, oftentimes companies are required to alter their internal controls for appropriate accounting and contracting to prevent future corruption. The appointment of compliance monitors and the implementation of programs and internal controls can be exceedingly

22. Id. at 8
23. Id. at 8
costly and span over multiple years totaling hundreds of millions of dollars (as was the case with the NPA and Siemens).\textsuperscript{25}

It appears that companies substantially underestimate the cost of NPAs to their own detriment, acting as a somber financial warning to other companies attempting to take advantage of the “quick fix” that NPAs provide. Overall, the costly process of penalties, investigation, and remediation severely impact a company’s reputation, sales, and financial stability causing the need to thoroughly evaluate all potential costs before entering into an NPA.

C. The Pressures of Periodic Reporting and Extensive Due Diligence Requests

The extensive due diligence requirements are apparent in the DOJ agreement with Halliburton. The time constraints for periodic reporting at the outcome of their due diligence phases are extremely narrow, requiring reports after 10 days, 90 days, 120 days, and 180 days.\textsuperscript{26} In addition, all FCPA due diligence must be completed within one year after closing.\textsuperscript{27} These short time frames do not allow Halliburton to do much else but focus on completing all relevant reporting for a minimum of 180 days after closing. Such deadlines would require an acquiring company to maintain a due diligence team composed of attorneys, financial auditors, specialists and compliance personnel working around the clock in order to make progress.

When evaluating whether a company should enter into an NPA to protect their potential merger, a company should consider whether it can feasibly meet any and all deadlines posed by the DOJ. Failure to meet the deadlines could result in a revocation of the NPA, a reality that has forced companies to hire employees to work exclusively on periodic reporting and due diligence which can prove to be a costly move.

D. DOJ Discretion and Interference

The DOJ has vast discretion in their compliance requirements, one of which is usually mandating the equivalent of a guilty plea. Seen as a powerful tool for the DOJ, NPAs often require that a company acknowledge a guilty plea to the FCPA violations before being able to engage in remedial measures.\textsuperscript{28} For companies such as Halliburton, who was not completely aware as to the extent of Expro’s indiscretions, these


\textsuperscript{27} Id.

guilty pleas can be especially damaging because it is forcing a company to agree that they have violated the FCPA without actually knowing whether this is the reality.

It is a fallacy for companies to believe that once they enter into an NPA they will no longer face prosecution for FCPA violations. In fact, entering into these agreements allows the DOJ greater discretion in pressing criminal charges against the company. The amount of records required to be disclosed to the DOJ following extensive monitoring and due diligence programs are enough to allow the DOJ to effectively prosecute a case against the company should they feel as though the company is not substantially complying with the requirements laid out in the agreement.\textsuperscript{29} Prosecutors retain the right to revoke NPAs at their discretion and in fact have.\textsuperscript{30} In May of 2015, the DOJ withdrew its NPA with financial powerhouse UBS claiming that the bank had violated the terms of the agreement.\textsuperscript{31} This ultimately forced UBS to plead guilty to all conduct that it had previously retained immunity from which furthers the initial point that the DOJ retains substantial discretion in forcing a company into admissions of guilt.

It appears that entering into these negotiations places the company at high risk for future litigation if there is any indication of non-compliance. Consistent oversight and monitoring becomes increasingly difficult for companies who do not have the financial ability to monitor every employee at all points in time.\textsuperscript{32} The reality is that if a company fails in an oversight or compliance measure, the DOJ reserves the right to rescind their NPA and to begin prosecution efforts with the information obtained through the periodic reporting requirements laid out in the offer. This ability negates the reason why a company entered into an NPA in the first place—to avoid a public indictment—and further proves that entering into these agreements does not protect a company from future litigation, in fact it ensures that a company will be found guilty by its own admission should litigation proceed.

V. RESOLVING FCPA VIOLATIONS IN AVOIDANCE OF NON-PROSECUTION AGREEMENTS

While there are no easy solutions when a company faces inevitable FCPA violations while in the midst of a merger or acquisition, it is strongly suggested that a company be wary of the substantial negative impacts of entering into an NPA. The most practical advice in this situa-

\textsuperscript{29}. 2015 Mid-Year Update on Corporate Non-Prosecution Agreements (NPAS) and Deferred Prosecution Agreements (DPAS), Gibson Dunn, at 3, (July 2015), available at http://www.gibsondunn.com/publications/Documents/2015-Mid-Year-Update-Corporate-Non-Prosecution-Agreements-and-Deferred-Prosecution-Agreements.pdf
\textsuperscript{30}. Id. at 3
\textsuperscript{31}. Id. at 10
\textsuperscript{32}. Id. at 4
tion is to avoid entering into an NPA by engaging in comprehensive due diligence and risk assessment prior to the acquisition of a target company. Should an NPA become inevitable, a company should seek contractual indemnification and negotiate the payment of the remedial costs from the target company, ultimately altering all initial price negotiations.

A. Avoidance of Non-Prosecution Agreements Through Adequate Due Diligence

The most practical avenue for a company to avoid entering into an NPA is through FCPA related due diligence and risk assessment. This allows the acquiring company to know the risks and potential threats before moving forward with any finality. In order to engage in effective FCPA due diligence, a company must first create an effective due diligence team, then due a preliminary “desktop review” of relevant information, request specific documents for review, engage in interviews and utilize questionnaires, and finally review all relevant financial records.33

The first step is forming a due diligence team composed of attorneys knowledgeable in the FCPA as well as local counsel with knowledge of the local anti-bribery laws.34 It may also be beneficial for a company to include forensic accountants, HR compliance personnel, or specialists in the industry and culture of the target company and its subsidiaries.35

After a formation of the due diligence team, a company should engage in a precursory review of available data. This review should give insight into the extent that a target company has corruption vulnerabilities, any prior exposure, the location and nature of the business, and its operations.36 Initially, an acquiring company can evaluate risk by identifying the location of the target company and its subsidiaries. After identifying the company’s locations, a company’s corruption risk can be evaluated using the “Corruption Perception Index,” which is an online resource providing scores for all countries based on multiple risk factors.37 From here, further review can be done in regards to any negative press the company has had publicized related to corruption or bribery, as well as what remedial steps, if any, were published.

After the precursory review, it is extremely important that the acquiring company conduct interviews of key personnel. Key personnel can include human resources employees, compliance officers, operational officers, or persons knowledgeable about sales, marketing, or accounting.\textsuperscript{38} These interviews should allow the acquiring company to gain a better understanding about the culture of the company, the personalities of key figures, potential risk areas, company operations, and relationships with third party contractors.\textsuperscript{39} By actively investigating potential risks through interviews, an acquiring company can begin to discern whether there is a high risk for FCPA violations or related litigation.

In tandem with key personnel interviews, an acquiring company should begin a thorough document review. The acquiring company should include the following in the requested documents list:

- documents outlining the target company’s code of conduct;
- anticorruption policies and procedures (if any);
- personnel responsible for compliance oversight;
- any documents pertaining to a prior FCPA investigation, violation, or penalty;
- third party contracts;
- permits and licensing;
- employee anti-corruption training programs;
- contracts or agreements with foreign officials;
- financial records including profit and loss statements, general ledgers; and
- travel and entertainment expense reimbursements.\textsuperscript{40}

Should a company discover information that would lead them to believe a FCPA violation does exist, is inevitable, or that there is some level of risk of occurrence, the company can then assess what remedial measures, if any, could mitigate the problem and the cost of such measures. By engaging in active due diligence an acquiring company can spot a problem, begin to assess potential solutions, and then engage the target company in price negotiations. If the risk proves to be too vast to solve, an acquiring company can terminate negotiations without having to engage in any form of an NPA with the DOJ. Spotting issues before-

\textsuperscript{38} Id.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
hand through effective FCPA due diligence could potentially save the acquiring company from the pitfalls of NPAs.

B. Non-Prosecution Agreements as a Last Resort

If an NPA appears to be the only option to form a successful merger, greater indemnification and negotiations for a price that reflect the cost of remedial measures and extensive reporting requirements should be implemented into a corporation’s strategy for protecting itself and its shareholders.

At the outset of the deal, an acquiring company can implement FCPA representations and warranties that specifically refer to both the FCPA and local bribery laws and state that the target company does not have knowledge of any current FCPA violations. Furthermore, an acquiring company can integrate indemnification provisions into the agreement that require that the acquirer be indemnified in the event of any breach of the FCPA representations and warranties.

Lastly, an acquiring company can utilize post-closing covenants that condition closing on the target company having no FCPA violations after due diligence is performed. Should there be a violation found, an acquiring company can request post-closing covenants that seek remedial efforts, cost-sharing mechanisms for the implementation of compliance programs, or terminations of certain third party contracts that have been found to be in violation of the FCPA or local bribery laws.

By employing contractual measures, a company provides itself with added protections before having to turn to the DOJ for an NPA. In addition, contractual agreements regarding costs associated with FCPA violations may lessen the burden of having to turn to an NPA to avoid active litigation.

VI. CONCLUSION

Though NPAs appear to be a viable alternative to litigation, they are not a means to the end of an FCPA investigation they are merely the beginning. The many pitfalls associated with entering into agreements that require costly monitoring programs and persistent government involvement should stand as a warning to companies seeking shelter from the DOJ. In lieu of entering into a costly and imposing agreement with the DOJ, companies should consider doing a more extensive risk assessment and a cost-benefit analysis before acquiring target companies with potential FCPA violations. Should the company insist on moving forward with an NPA, contractual provisions should be in place with the target com-

42. Id. at 106
pany as additional protection before doing so. In the end, there is no easy solution for acquiring companies, however utilizing practicality and weighing the vast monetary impacts of such agreements is in the best interest of companies faced with the difficult decision of self-reporting FCPA violations to avoid public indictments.

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