Due diligence on corrupt practices

Despite more than a decade of deal-making experience in the Middle East, Africa, Eastern Europe, Latin America and Asia, corporate investors in emerging markets still face many risks. These include labor and environmental liabilities, opaque accounting practices and conflicts of interest. The biggest risk, however, may be violation of the US Foreign Corrupt Practices Act (FCPA), which prohibits US companies from bribing foreign officials to obtain or retain business.

Several corporations have been fined record amounts in cases linked to bribery and corruption, and more than 120 US companies are said to be under investigation, many for practices they unwittingly inherited during acquisitions. Yet nearly 30% of companies that acquired a new business in the last two years "never or infrequently" considered bribery or corruption risks in the context of a potential acquisition, according to Ernst & Young's 10th Global Fraud Survey, "Corruption or Compliance: Weighing the Costs."

High standards. In recent years, the Securities and Exchange Commission and the Department of Justice (DOJ) have stepped up their enforcement of the FCPA, which was enacted in 1977 to prevent and punish corporate bribery and corruption. Recent enforcement actions have included matters relating to subsidiaries, employees, joint ventures, offshore entities and agents acting on a company's behalf anywhere.

In June 2008, the DOJ issued the Halliburton Opinion in response to an inquiry from the energy company about its liability related to a UK-based acquisition target. The target had operations in regions where corruption is a known risk and also counted national oil companies as customers. Because UK law limited its ability to conduct extensive due diligence prior to closing, Halliburton wanted the DOJ to determine whether the acquisition would violate the FCPA and if the company could inherit FCPA violations and be held liable for the target's conduct.

The DOJ determined that a 180-day period was a reasonable time frame to allow Halliburton to complete its due diligence. During this period, Halliburton would not be liable for prior illegal activity associated with its new acquisition, provided it took appropriate steps to stop those activities, put in place proper controls and ensured that no violations occurred on its watch.

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The DOJ opinion applies only to Halliburton. However, it strongly illustrates the DOJ's view of the importance of FCPA due diligence and the high standards it expects. It demonstrates the need for companies making global acquisitions to have a robust FCPA and an anti-corruption due diligence process. Halliburton's commitment to successfully implement its FCPA and anti-corruption program, disclose and promptly resolve violations discovered post-close, and meet the DOJ's other rigorous requirements was key.

Some companies are taking proactive steps to fast-track investigations and lay any concerns to rest. The acquirer must show that great effort was expended to ensure that current activity is lawful and that, when violations were identified, actions to address them were taken. Ultimately, the new parent bears responsibility for the people, practices and activities brought along with a purchase, irrespective of when and where questionable action occurred. Liability is long-lived.

Ferreting out fraud. Would-be buyers should conduct an FCPA compliance assessment as a first step in considering deals – before, not along with or after traditional due diligence. Prioritize acquisition targets according to the perceived corruption of their home countries, as measured by Transparency International, a nonprofit organization long recognized for reliably ranking countries by risk metrics.

While the developing nations promise strong growth in several sectors, high costs to clean up or close operations, even within an outsourced distributor or sales office, may argue for walking away. Risk-averse lenders will also welcome early due diligence.

Secondly, conduct exhaustive forensic research early and often, utilizing resources on the ground who understand local practices and US specialists who understand the implications. Spend time in the country to spot red flags like a near-monopoly in a market. Illegal payments or favors may be involved.

Finally, don't restrict FCPA due diligence to the obvious targets. And if you plan a divestiture, vet your own operations down to the sales or supplier level to ensure full compliance. Failure to do so could derail a deal, or worse.

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