FOREIGN CORRUPT PRACTICES ACT

FCPA DUE DILIGENCE IN THE CONTEXT OF MERGERS AND ACQUISITIONS

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Introduction

Mergers and acquisitions serve as important instruments for companies to enter global markets. In 2007, worldwide merger and acquisition activity totaled $4.38 trillion.[1] Major target companies include both privately held firms and state-owned enterprises in a variety of sectors, including telecommunications, financial services, health care, energy, and transportation. The U.S. Foreign Corrupt Practices Act (FCPA) poses crucial challenges for companies seeking to gain a foothold in new markets via mergers or acquisitions, particularly where targets are foreign companies or have extensive foreign operations.

Under the FCPA, an acquiring company may be held liable for any prior unlawful payments made by the acquired company. FCPA prosecutions in the context of mergers and acquisitions are an increasingly significant area. In 2007, nearly one-half of U.S. FCPA prosecutions arose from pre-acquisition due diligence and disclosure by acquiring companies. Such actions can scuttle deals and result in criminal charges, penalties and reputational damage. Consequently, it is critical for acquiring companies to conduct FCPA-specific due diligence to evaluate and resolve any potential FCPA problems before the deal closes. This article discusses recent FCPA cases in the mergers and acquisitions context and provides guidance on basic strategies for businesses to finalize deals in order to avoid FCPA liability with respect to pre-acquisition activities of the target company.

Pre-Acquisition Due Diligence under the FCPA

Under the FCPA, mergers and acquisitions do not extinguish liability for past unlawful conduct by the acquired company.[2] The FCPA will hold the new company or the newly acquired subsidiary liable based on the

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1. Hall, J., *U.S. Mergers Hit New Record, but Lag Europe*, Int'l Herald Trib., (Dec. 20, 2007), *available at* http://www.iht.com/articles/reuters/2007/12/20/business/OUKBS-UK-MERGERS-US.php.

2. *See e.g.*, DOJ Foreign Corrupt Practices Act Opinion Procedure Release No. 03-01 (Jan. 15, 2003).

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target's pre-acquisition conduct. Such liability applies not only to U.S.-based companies, but also to foreign issuers whose American Depository Receipts (ADRs) trade on U.S. financial exchanges. Companies must exercise due diligence by taking affirmative steps to determine whether transactions in which they are involved violate or could violate the FCPA. Under the FCPA, knowledge of a violation can be inferred if the circumstances of the illegal payment were relatively evident and the company did not undertake an investigation to establish facts to the contrary. Further, the FCPA prohibits companies from circumventing liability through "conscious disregard" or "deliberate ignorance" of the circumstances surrounding a transaction. Relevant case law and a recent U.S. Department of Justice (DOJ) Opinion Procedure Release described below provide guidance on the level of FCPA due diligence that the DOJ finds appropriate.

SUMMARY OF FCPA CASES INVOLVING PRE-ACQUISITION DUE DILIGENCE

The following provides a case-by-case summary highlighting the potential FCPA compliance risks related to mergers and acquisitions. These cases show the improper activities by target entities and the importance of identifying similar illegal conduct prior to closing.

Investment Group's Acquisition of ABB Subsidiaries

In October 2003, an investment group, including JPMorgan Partners Global Fund, Candover 2001 Fund, and 3i Investments plc (Investment Group) sought to acquire certain subsidiaries from ABB Ltd. (ABB).[3] ABB, a Swiss corporation, is a global provider of power and automation technologies, including oil and gas projects, with subsidiaries in the United States and several foreign countries. Pre-acquisition due diligence uncovered several potential FCPA violations by ABB's subsidiaries.

According to the U.S. Securities and Exchange Commission (SEC), from 1998 through 2003, ABB's U.S. and foreign subsidiaries made improper payments totaling over $1.1 million to government officials in Angola, Nigeria, and Kazakhstan.[4] At least $865,000 in payments were made after ABB became a reporting company in the United States in April 2001. In Angola, ABB's subsidiary made improper payments in the form of training trips for engineers at the Angolan state-owned oil company responsible for making technical evaluations to secure contracts. In Nigeria, ABB's subsidiary provided cash and gifts, directly and through an intermediary, to officials of a state-owned agency responsible for overseeing investment in petroleum exploration and production to secure oil and gas projects. In Kazakhstan, an ABB subsidiary made payments to an employee of a government-owned oil and gas company.

3. *See* DOJ Foreign Corrupt Practices Act Review, Opinion Procedure Release No. 04-02 (July 12, 2004).

4. *See* Complaint, *SEC v. ABB Ltd.*, 04-cv-01141 (2004), ¶ 1 (ABB Complaint).

Upon discovery in 2003, ABB made a voluntary disclosure to the DOJ and the SEC. Resolution of ABB's potential FCPA liability was a key condition of the sales agreement between ABB and the Investment Group. A subsequent FCPA internal investigation involved more than one hundred lawyers, approximately four million documents, and more than one hundred interviews in twenty countries.[5] One year later, the agencies alleged that ABB's payments were made with the knowledge and approval of management-level personnel of the relevant ABB subsidiaries.[6] Further, the company lacked internal controls to prevent or detect illicit payment and improperly recorded these payments in its accounting books and records.[7]

In July 2004, ABB agreed to a settlement with the SEC requiring it to pay a $10.5 million civil penalty and a $5.9 million disgorgement of alleged profits.[8] In addition, ABB agreed to retain an independent FCPA compliance consultant. In accepting ABB's settlement, the SEC noted the company's "full cooperation" during the agency's investigation. In the DOJ proceeding, ABB's subsidiaries, ABB Vetco Gray, Inc. and ABB Vetco Gray UK, each pled guilty to two felony counts of FCPA violations and were assessed criminal fines totaling $10.5 million.[9] The SEC deemed ABB's $10.5 million civil penalty satisfied by the subsidiaries' payments of criminal fines.

The DOJ then issued an Opinion Procedure Release to the Investment Group.[10] The release stated that the DOJ did not intend to take any enforcement action against the purchasers or their recently acquired entities for FCPA violations committed prior to their acquisition from ABB, provided they commit to several compliance measures, including: (1) disciplining any employees found to have engaged in any improper payments; (2) ensuring the adoption of a rigorous anti-corruption compliance code; (3) implementing internal accounting controls designed to ensure accurate books and records; (4) disclosing any later-discovered pre-acquisition payments; and (5) continuing to cooperate with the DOJ and SEC in their investigations. Upon issuance of this Opinion Procedure Release, the Investment Group purchased ABB's subsidiaries.

Monsanto's Acquisition of Delta & Pine Land Company / Turk Deltapine, Inc.

Turk Deltapine, Inc. (Turk) is a wholly owned U.S.-based subsidiary of Delta & Pine Land Company (Delta), a U.S. corporation engaged in

5. *See* FCPA Op. Proc. Rel. No. 04-02.
6. *See* ABB Complaint, at ¶ 1.
7. *See id.*, at ¶ 1.
8. *See SEC v. ABB, Ltd.*, SEC Litigation Release No. 18755 (July 6, 2004).
9. *See id.*
10. *See* FCPA Op. Proc. Rel. No. 04-02.

the breeding, production, and marketing of cottonseed. Monsanto Company acquired Delta on June 1, 2007.[11]

During the pre-acquisition due diligence, Monsanto discovered improper payments made by Turk and reported them to the SEC. According to the SEC complaint, from 2001 to 2006, Turk made payments valued at $43,000, including cash, travel, and computers, to officials of the Turkish Ministry of Agricultural and Rural Affairs to secure government inspection reports and quality certifications necessary for its operations in Turkey.[12] In May 2004, Delta learned that Turk was making payments to officials, but failed to receive all the facts, and permitted payments to continue through a third party supplier.

On July 25, 2007, Delta and Turk settled with the SEC.[13] Delta and Turk agreed to a $300,000 civil penalty to be paid jointly and severally. The SEC also filed a cease-and-desist order against Delta and Turk, alleging that Turk had violated the anti-bribery provisions of the FCPA and that Delta had violated the FCPA's books and records and internal controls provision. Delta also agreed to retain an independent monitor to review and make recommendations to enhance the company's FCPA compliance policies and procedures.

Coastal Corporation's Merger with El Paso Energy Corporation

In January 2001, the Coastal Corporation (Coastal) merged with El Paso Energy Corporation, a wholly owned subsidiary of Texas-based energy company El Paso Corporation (collectively, El Paso).[14] The SEC concluded that El Paso violated the FCPA's books and records and internal controls provisions by indirectly making $5.5 million in illegal surcharge payments in connection with purchases of crude oil from third parties under the United Nations (UN) Oil-for-Food Program.[15] The third-party companies paid kickbacks to Iraqi-controlled accounts at banks in Jordan and Lebanon via surcharges on shipments of crude oil from Iraq's State Oil Marketing Organization. According to the SEC complaint, the demands for surcharge payments began with Coastal in September 2000 prior to the merger with El Paso, and continued post-acquisition. The SEC alleged that El Paso failed to maintain an adequate system of internal controls to detect and prevent improper payments by third parties.

On February 7, 2007, El Paso agreed to pay a civil penalty of $2.2 million to the SEC.[16] In a separate agreement with the DOJ dated February 7, 2007, El Paso entered into a non-prosecution agreement resulting

11. See *SEC v. Delta & Pine Land Co.*, SEC Litigation Release No. 20214 (July 26, 2007).

12. *See* Complaint, *SEC v. Delta & Pine Land Co. and Turk Deltapine, Inc.*, No. 07-cv-1352 (D.D.C. 2007) at ¶ 4.

13. See *SEC v. Delta & Pine Land Co.*, Lit. Rel. No. 20214 (July 26, 2007)

14. *See SEC v. El Paso Corp.*, SEC Litigation Release No. 19991 (Feb. 7, 2007).

15. See Complaint, *SEC v. El Paso Corp.*, l:07-cv-00899 (S.D.N.Y. 2007), at ¶¶ 1-3.

16. *See SEC v. El Paso Corp.*, Lit. Rel. No. 19991 (Feb. 7, 2007).

in a $5.5 million disgorgement of profits and obligating the company to continue cooperating fully with the DOJ and other law enforcement agencies.[17] The DOJ's agreement recognized El Paso's cooperation with the agency's investigation into the Oil-for-Food Program, commitment to continued cooperation, implementation of enhanced compliance procedures, and confirmation that culpable employees no longer worked for the company.

GE's Acquisition of InVision

In March 2004, General Electric Company (GE) announced its intention to acquire InVision Technologies, Inc. (InVision), a U.S. manufacturer of advanced explosives detection systems used for scanning baggage at airports around the world.[18] During pre-acquisition due diligence, GE uncovered several potential FCPA violations by InVision relating to the company's allegedly improper payments in three countries and its failure to devise and maintain an adequate internal controls system. In July 2004, InVision voluntarily disclosed these potential violations to the DOJ and SEC.[19] The companies extended the purchase agreement deadline until late December 2004 for InVision to resolve these potential FCPA violations with the U.S. government.

From June 2002 through June 2004, InVision marketed and sold its explosives detection systems, through local sales agents and distributors, to employees at state-owned airports in China, Thailand, and the Philippines.[20] According to the SEC, InVision was aware of the high probability that its agents or distributors in China, Thailand, and the Philippines had paid or offered to pay travel expenses and/or gifts to government officials to obtain or retain sales, but nevertheless allowed the agents or distributors to proceed with such transactions. Further, InVision failed to develop an adequate selection and training process for its sales agents and distributors employed outside the United States.[21]

In December 2004, InVision entered into to a non-prosecution agreement with the Justice Department.[22] InVision agreed to accept responsibility for its misconduct, pay an $800,000 penalty, and continue its cooperation with ongoing DOJ and SEC investigations. GE also entered

17. *See* U.S. Department of Justice, *U.S. Announces Oil-for-Food Settlement with El Paso Corporation* (Feb. 7, 2007), *available at* http://www.usdoj.gov/usao/nys/pressreleases/February07/elpasoagreementpr.pdf.

18. *See* Complaint, *In re General Electric Company*, FTC Docket No. C-4119 (Sept. 9, 2004), at ¶ 7.

19. *See InVision Settles Bribery Claims*, LOS ANGELES TIMES, Feb. 15, 2005, at C2.

20. *See In re GE InVision, Inc. (formerly known as InVision Technologies, Inc.)*, Exchange Act Release No. 51,199 (Feb. 14, 2005,) at ¶¶ 7-13.

21. *See id.*, at ¶¶ 15-16.

22. *See* U.S. Department of Justice, *InVision Technologies, Inc. Enters into Agreement with the United States* (Dec. 6, 2004), *available at* http://www.usdoj.gov/opa/pr/2004/December/04_crm_780.htm.

into a separate settlement agreement with the DOJ.[23] The DOJ agreed not to prosecute GE or its successor or subsidiary based on the transactions voluntarily disclosed by InVision prior to the acquisition. In exchange, GE agreed to integrate InVision into its compliance program, ensure that InVision complied with its obligations under the agreement, cooperate fully with the ongoing DOJ/SEC investigations, and retain an independent FCPA compliance monitor.

After GE InVision completed its merger,[24] the company entered into a settlement agreement with the SEC on February 14, 2005, imposing a $500,000 civil penalty, $589,000 disgorgement in profits, and $28,700 prejudgment interest, totaling $1.2 million, and a cease and desist order.[25]

Initial Public Offering of Paradigm B.V.

Paradigm B.V. (Paradigm), a private limited liability company registered in the Netherlands, is a software provider to oil and gas exploration and production companies with operations in Asia, the Middle East and Latin America. In July 2005, Paradigm relocated its principal place of business from Israel to Texas. In January 2007, while conducting due diligence in preparation for its anticipated initial public offering (IPO) on the U.S. stock exchange, Paradigm's parent company, Paradigm Ltd., discovered payments in violation of the FCPA.

According to the DOJ, from 2002 to 2007, Paradigm made corrupt payments in the form of commission payments and improper entertainment and travel via third party agents and consultants to secure business contracts in Nigeria, Mexico, Indonesia, China, and Kazakhstan.[26]

Upon discovering the improper payments, Paradigm's counsel made a voluntary disclosure to DOJ, conducted an internal investigation, and implemented a new compliance program. The DOJ entered into a non-prosecution agreement in September 2007, obligating Paradigm to pay a $1 million penalty, cooperate fully with the agency's investigation, adopt internal controls, and retain outside compliance counsel.[27] Subsequently, Paradigm withdrew its public stock offering in November 2007.[28]

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23. *See id.*

24. In December 2004, GE officially acquired InVision, which now operates under the name GE InVision, Inc.

25. *See SEC v. GE InVision Inc.*, SEC Litigation Release No. 19078 (Feb. 14, 2005).

26. *See* Non- Prosecution Agreement between Paradigm B.V., and the DOJ, Criminal Division (Sept. 21, 2007) Appendix A, at ¶¶ 5-20.

27. *See id.*, Apps. B and C; *see also* U.S. Department of Justice, *Paradigm B.V. Agrees to Pay $1 Million Penalty to Resolve Foreign Bribery Issues in Multiple Countries* (Sept. 24, 2007), *available at* http://www.usdoj.gov.

28. *See* Greg Barr, *Energy Software Firm Pulls Plug on Floating IPO*, HOUSTON BUSINESS JOURNAL (Dec. 17, 2007).

Statoil ASA Transaction with Norsk Hydro ASA

Statoil ASA (Statoil) is a publicly traded and partially government-owned Norwegian company with ADRs traded on the New York Stock Exchange. On October 1, 2007, Statoil ASA purchased Norsk Hydro ASA's (Hydro) oil and gas division to form StatoilHydro ASA (StatoilHydro).[29] That same day, StatoilHydro announced that it had initiated an external investigation of payments associated with Hydro's operations in Libya for possible violation of Norwegian and U.S. anti-corruption laws.[30]

According to press reports, in June 1999, Hydro inherited consultancy contracts involving Libyan oil fields through an acquisition of another Norwegian oil company, Saga Petroleum ASA (Saga).[31] The corruption allegations concerned payments agreed to by Saga under a January 1999 contract to acquire Libyan oil exploration acreage.[32] After the merger, Hydro paid the consultant fees under the agreement totaling $6.85 million in 2000 and 2001.[33] Hydro's petroleum business in Libya then was transferred to StatoilHydro as part of the October 1, 2007 merger.

StatoilHydro's Annual Report indicates that the company learned about the improper payments only five days before the merger.[34] StatoilHydro immediately hired a U.S. law firm to investigate the payments and notified Norway's National Authority for Investigation and Prosecution of Economic and Environmental Crime as well as the SEC.[35] StatoilHydro's chairman resigned during the first week of the merger.[36] On the first day of trading, StatoilHydro's combined share price fell.[37] The investigation remains ongoing.[38]

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29. *See Norway's StatoilHydro begins operations, announces probe of questionable Libya contracts*, INT'L HERALD TRIB. (Oct. 1, 2007).

30. *See id.*; *see also* StatoilHydro ASA, Form 20-F (2007 Annual Report) (Apr. 9, 2008), at 5.3.

31. *See Norway's StatoilHydro begins operations, announces probe of questionable Libya contracts*, INT'L HERALD TRIB. (Oct. 1, 2007).

32. *See id.*

33. *See id.*

34. *See* StatoilHydro, Form 20-F, at 5.3.

35. *See* Nina Berglund, *Bribery Investigation Mars 'StatoilHydro' Debut*, AFTENPOSTEN (Oct. 1, 2007), *available at* http://www.aftenposten.no/english/business/article2023532.ece.

36. *See* Wojciech Moskwa, *StatoilHydro CEO Sees Fast Recovery from Bribe Row*, REUTERS UK (Oct. 6, 2007), *available at* http://uk.reuters.com/article/oilRpt/idUKMOS65608320071006.

37. *See Norway's StatoilHydro begins operations, announces probe of questionable Libya contracts*, INT'L HERALD TRIB. (Oct. 1, 2007).

38. As a parallel concern, Statoil ASA settled with the U.S. government in 2006 on separate anti-bribery violations relating to payments to an Iranian government official to obtain oil and gas contracts in Iran. *See* U.S. Department of Justice, *U.S. Resolves Probe against Oil Company That Bribed Iranian Official* (Oct. 13, 2006), *available at* http://www.usdoj.gov.

Cardinal Health Acquisition of Syncor International Corporation

In June 2002, Cardinal Health sought to acquire Syncor International Corporation (Syncor), a Delaware corporation providing radiopharmacy and outpatient medical imaging services in the United States and in eighteen foreign countries.[39] Five months later, in connection with pre-acquisition due diligence, Cardinal Health discovered improper payments made by several of Syncor's foreign subsidiaries to doctors at state-owned hospitals in order to obtain or retain business. Syncor promptly initiated an investigation and made a voluntary disclosure to the SEC and DOJ, resulting in government investigations and prosecutions.

According to the SEC complaint, from the mid-1980s through September 2002, Syncor subsidiaries in Belgium, France, Mexico, Luxembourg, and Taiwan made at least $600,000 in corrupt payments to doctors through direct gifts, inflated invoicing, and improper referral commissions, to ensure the doctors and the state-owned hospitals would order Syncor radio-pharmaceutical supplies and services.[40] Further, the SEC alleged that the payments were made with the knowledge and approval of the subsidiaries' senior officers, and occasionally with the knowledge and approval of the parent's founder and board chairman. The SEC also charged Syncor with violating the FCPA's books and records provision and internal controls.

In December 2002, Syncor entered into a civil settlement with the SEC by paying a $500,000 civil fine, consenting to an administrative cease and desist order, and agreeing to engage an independent consultant to review and make recommendations concerning the company's FCPA compliance procedures. The SEC also noted that it considered Syncor's self-reporting and full cooperation in deciding to accept the settlement offer.[41] In addition, in December 2003, Syncor's subsidiary, Syncor Taiwan, separately pled guilty to FCPA violations and agreed to pay a $2 million fine.[42] Following Syncor's investigation and disclosures, Cardinal Health agreed to proceed with the acquisition, but only at a lower price.[43]

Lockheed Martin's Proposed Merger with Titan Corporation

In September 2003, Lockheed Martin Corporation (Lockheed) and The Titan Corporation (Titan) signed a merger agreement with a March

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39. *See* Complaint, *SEC v. Syncor International Corp.*, No. 02-cv-02421 (D.D.C. 2002), at ¶ 2.

40. See *id.*, at ¶ 3 and ¶¶ 5-22.

41. *See SEC v. Syncor Int'l Corp.*, Litigation Release No. 17887 (Dec. 10, 2002).

42. *See* Plea Agreement, *United States v. Syncor Taiwan, Inc.*, No. 02-cr-1244 (C.D. Cal. Dec. 10, 2002).

43. *See* Press Release, Cardinal Health, Cardinal Health and Syncor Announce Amended Merger Agreement, *available at* http://www.cardinal.com/content/news/1262002_73434.asp.

2004 closing date.[44] During its pre-acquisition due diligence into Titan, Lockheed discovered potential violations of the FCPA's improper payments and books and records provisions. In February 2004, Lockheed and Titan filed voluntary disclosures with the DOJ and SEC. Both agencies subsequently opened investigations.

In April 2004, Lockheed and Titan signed a revised merger agreement setting a new deadline for the merger (June 25, 2004) and reducing Lockheed's offer. On June 24, Titan announced it was unable to meet the deadline for an agreement with the DOJ. Lockheed refused to revise the deadline and announced its termination of the acquisition agreement with Titan on June 26, 2004.[45] The following year, Titan entered into the settlement of an enforcement action with the SEC and a plea agreement with DOJ.[46] As to both, Titan paid combined penalties, fines and disgorgement totaling over $28 million.

On March 1, 2005, Titan pleaded guilty to two felony counts of violating the anti-bribery provision of the FCPA and to one felony count of filing a false tax return.[47] Titan agreed to pay $13 million in criminal fines, $15.5 million in disgorgement and prejudgment interest to settle a parallel civil case brought by the SEC. In addition, Titan agreed to retain an independent monitor to review Titan's FCPA compliance policies and procedures and to draft a report documenting its findings and recommendations for Titan's board of directors and the SEC.

Tyco International Acquisition of Brazilian and South Korean Companies

Tyco International Ltd. (Tyco), a Bermuda corporation, is a manufacturing and service company involved in electronic security services, electrical and electronic components, fire protection and safety systems, medical products, and engineered products and services. Tyco's stock is traded on the New York Stock Exchange.

According to the SEC complaint filed in 2006, in 1998, Tyco acquired a Brazilian engineering company, Earth Tech Brasil Ltda. (Earth Tech), engaged in construction and operation of water, wastewater, sewage and irrigation systems for various Brazilian government entities.[48] The SEC noted the acquisition closed despite due diligence revealing that improper payments to government officials were common in Brazil and seen as necessary in Earth Tech's line of business. The SEC charged that from 1999 through 2002, Earth Tech made improper payments and provided entertainment to various Brazilian officials to obtain business. Further, the SEC noted that approximately sixty percent of Earth Tech's total contracts involved payments to government officials.

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44. *See* Complaint, *SEC v. Titan Corp.*, No. 05-0411 (D.D.C. March 1, 2005), at ¶ 8.
45. *See id.*, at 2.
46. *See SEC v. Titan Corporation*, SEC Litigation Release No. 19107 (March 2005).
47. *See id.*
48. *See* Complaint, *SEC v. Tyco International Ltd.*, No. 06-cv-2942 (S.D.N.Y. 2006), at ¶¶ 48-52.

In addition, the SEC alleged that, in 1999, Tyco acquired Dong Bang Industrial Co. Ltd. (Dong Bang), a South Korean fire protection services company.[49] The SEC again noted that Tyco's pre-acquisition due diligence had revealed the prevalence of improper payments in the South Korean contracting business. From 1999 through 2002, Dong Bang also made cash payments and provided entertainment to various government officials to obtain work on state-controlled projects.

According to the SEC complaint, prior to 2003, Tyco had no company-wide FCPA compliance program or internal controls sufficient to detect misconduct among its global subsidiaries and employees at Earth Tech, and that Dong Bang received inadequate post-merger FCPA compliance guidelines.[50] In 2003, Tyco engaged outside counsel to conduct an international investigation and, in 2005, Tyco reported the investigation's results to the SEC and DOJ.[51] In April 2006, Tyco and the SEC reached a settlement agreement on numerous federal securities law violations, including a single FCPA anti-bribery violation. Tyco agreed to pay a $50 million civil penalty and $1 disgorgement.[52]

Johnson Controls Acquisition of York International

In August 2005, Johnson Controls, Inc. (Johnson) acquired York International Corporation (York), a global provider of heating, ventilation, air conditioning, and refrigeration products and services.[53] Prior to finalizing the merger, the UN informed York that it had discovered possible improper transactions under the UN Oil-for-Food Program. York initiated an internal investigation and made a voluntary report to the SEC and DOJ. Johnson and York then completed the merger on December 9, 2005.[54]

According to the SEC, from 2001 through 2006, York's subsidiaries made $647,000 in improper payments under the UN Oil-for-Food Program, paid approximately $500,000 to an intermediary knowing that the money was intended for government officials in the United Arab Emirates, and concealed $7 million in illicit consultancy payments to secure commercial and government projects in China, Europe, India, Nigeria, and the Middle East. The SEC charged that York violated the FCPA by failing to maintain an effective system of internal controls and inaccurately recorded payments in its books and records.[55]

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49. *See id.*, at ¶¶ 53-54.
50. *See id.*, at ¶ 55.
51. *See Tyco probing compliance with Foreign Corrupt Practices Act*, ASSOCIATED PRESS (May 11, 2005).
52. *See* Securities and Exchange Commission, *SEC Brings Settled Charges against Tyco International Ltd. Alleging Billion Dollar Accounting Fraud* (Apr. 17, 2006), *available at* http://www.sec.gov/news/press/2006/2006-58.htm.
53. *See SEC v. York International Corporation*, SEC Litigation Release No. 20319 (Oct. 1, 2007).
54. *See* Johnson Controls, Inc., Form 8-K (Dec. 9, 2005).
55. *See SEC v. York*, Lit. Rel. No. 20319 (Oct. 1, 2007).

York agreed to a final judgment ordering disgorgement of $9 million in profits plus a $2 million civil penalty. York also agreed to retain an independent compliance monitor.[56] In addition, York entered into a three-year deferred prosecution agreement with the DOJ obligating payment of an additional $10 million fine.[57]

DOJ Opinion Procedure Release No. 08-02

In many of the cases described above, pre-acquisition due diligence provided the acquiring company with a full understanding of potential FCPA risks. However, in those situations where sufficient FCPA due diligence cannot occur until after closing, the DOJ recently offered detailed guidance to lessen FCPA liabilities inherited from the target company.

On June 13, 2008, the DOJ issued Opinion Procedure Release 08-02[58] concerning Halliburton Company's (Halliburton) potential FCPA liability in connection with a proposed acquisition of a U.K. company specializing in upstream oil and gas products and services with global operations in over fifty countries. Halliburton submitted a request to the DOJ raising three issues: (1) whether the proposed acquisition would violate the FCPA; (2) whether Halliburton would "inherit" any FCPA liabilities of the U.K. company through the proposed acquisition; and (3) whether Halliburton would be held criminally liable for any post-acquisition unlawful conduct by the U.K. company prior to completing its FCPA due diligence if such conduct is reported to the DOJ within 180 days after closing.

Halliburton sought guidance due to U.K. legal impediments, which prevented access to the information necessary to complete appropriate FCPA due diligence prior to closing. Further, Halliburton was required to sign a confidentiality agreement with the U.K. company effectively preventing disclosure of information obtained during the bidding process to the DOJ.

Halliburton informed the DOJ that, if successful in acquiring the U.K. company, it intended to implement a post-closing plan. First, Halliburton would meet with the DOJ to disclose whether information made available pre-closing suggested any existing FCPA issues. Second, within ten days after closing, Halliburton would present the DOJ with an FCPA due diligence work plan addressing third-party intermediaries, joint ventures, customs, immigration, tax, and government licenses and permits. Third, at intervals of 90, 120, and 180 days after the closing, Halliburton, would report to the DOJ the results of its high, medium and low risk due

56. *See id.*

57. *See* Department of Justice, *Justice Department Agrees to Defer Prosecution of York International Corporation in Connection With Payment of Kickbacks Under the U.N. Oil For Food Program* (Oct. 1, 2007), *available at* http://www.usdoj.gov/opa/pr/2007/October/07_crm_783.html.

58. *See* FCPA Opinion Procedure Rel. 2008-02 (June 13, 2008), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2008/0802.html.

diligence, respectively. Fourth, Halliburton would retain external counsel and third-party consultants to conduct FCPA due diligence to include company records, e-mail review and employee interviews. Fifth, Halliburton would require all third-party intermediaries to sign new contracts incorporating FCPA representations and warranties, provisions and audit rights. Sixth, Halliburton would impose its FCPA compliance policies and procedures on the U.K. company immediately upon closing. Within sixty days after closing, Halliburton would provide FCPA training to U.K. company employees. Finally, Halliburton would maintain the U.K. company as a wholly owned subsidiary pending any DOJ investigation relating to the company's FCPA activities.

Based on Halliburton's representations, the DOJ determined that it did not presently intend to take any enforcement action against Halliburton for the acquisition of the U.K. company. The DOJ emphasized that since the U.K. company is a public company listed on a major exchange, any amount paid by Halliburton to acquire the company would go to shareholders, rather than the company itself. Therefore, the DOJ did not consider that such amounts could be used to make payments under the company's pre-existing unlawful agreements "in furtherance of" a bribe. Further, the DOJ noted the unlikelihood that the U.K. company's shareholders had corruptly obtained shares, as well as the impracticality of determining shareholder identities.

The DOJ also stated that it did not presently intend to take enforcement action for pre-acquisition conduct by the U.K. company disclosed to the DOJ within 180 days after closing provided that Halliburton satisfactorily implemented its post-closing FCPA compliance plan.

In addition, the DOJ stated it had no present intent to take any enforcement action against Halliburton for any post-acquisition FCPA violations by the U.K. company assuming Halliburton satisfactorily proceeded with its post-closing FCPA compliance plan. While the DOJ noted that an acquiring company may be held liable for any unlawful payments made by an acquired company post-acquisition, the DOJ recognized the insufficient time and inadequate access to complete pre-acquisition FCPA due diligence and remediation under U.K. law. Consequently, the DOJ concluded that Halliburton's ability to prevent unlawful payments by the U.K. company during the period immediately after the closing was severely compromised. The DOJ stated that the Opinion Release was intended to advance the DOJ's interest "in enforcing the FCPA and promoting FCPA due diligence in connection with corporate transactions."

The DOJ reserved its right to take enforcement action against Halliburton with respect to any FCPA violations committed by the U.K. company not disclosed during the 180-day period, violations committed at any time where Halliburton knowingly participates in the improper conduct, and any issues identified within the 180-day period that remained open and under investigation within one year after closing. Further, the DOJ stated that the Opinion Release provided no protection for any conduct occurring after the 180-day period. In addition, the DOJ reserved the right to prosecute or take enforcement action against the U.K. company for FCPA violations either pre- or post-acquisition, whether disclosed or not to the Department.

Lessons Learned

The cases and DOJ Opinion Procedure Releases highlight several important lessons for companies' due diligence to identify and mitigate FCPA-related risks.

1. Discovering Prior FCPA Violations. In most of the cases above, uncovering prior FCPA violations resulted from due diligence preceding the transaction. For example, in *Syncor, GE/InVision, Titan,* and *ABB,* the companies submitted voluntary disclosures to the U.S. government prior to finalizing the deals. In these cases, it was the transaction itself that led to discovery of the improper payments rather than stand-alone FCPA internal investigations by the target companies. However, while in most cases the timing of the discovery occurred several months before the closing, in *Syncor*, the chairman learned about FCPA misconduct only five days before the merger. As a result, on the first day of the merger, the company had to announce an internal investigation rather than celebrate its first day as a new company. In addition, in another case, *Tyco*, while the due diligence failed to uncover specific illicit activities, the agencies believed the acquiring company was on notice during the pre-acquisition review given the local culture. In this instance, misconduct by the target companies was uncovered several years following the acquisition.

2. Impact on the Target and Acquiring Companies. Discovering prior FCPA misconduct during the pre-acquisition due diligence phase can critically impact the deal. Such activities may bear on the true value of the target and can change the sales price of the transaction. Acquiring companies must consider the portion of the target's revenue that depends on inappropriate and unsustainable business practices. In this sense, companies must immediately halt illegal conduct by dismissing employees, voiding contracts reliant on improper payments, and conducting a broader investigation, as well as integrating a culture of compliance into the new company. Depending on whether these illicit activities can be immediately remedied, the deal may be delayed or cancelled altogether. In addition, companies could face costly internal investigations and possible reputational damage. Companies also are encouraged to self-report to the DOJ and SEC to investigate any potential impact. Voluntary disclosure requires cooperating with U.S. government investigations of the alleged FCPA violations and implementing comprehensive compliance programs. Disclosure also may lead to prosecution, independent monitors, and monetary penalties. While FCPA liabilities may not immediately end a merger or acquisition, companies need to work together with the U.S. government to resolve FCPA issues prior to closing.

3. Successful Resolution of FCPA Issues. In *GE/InVision*, the terms of the merger agreement required resolution of the FCPA issues before the merger could proceed. InVision's voluntary disclosure, ongoing cooperation with the DOJ and SEC investigations, and prompt remedial action enhanced InVision's ability to resolve the FCPA investigation. While settling the matter delayed the transaction, GE and InVision successfully completed the deal. Similarly, in *Syncor*, the deal was delayed until the investigation was concluded and the U.S. government completed agreements with the companies, but the companies reached a deal. This shows that a merger or acquisition may proceed if a thorough yet prompt internal investigation occurs in conjunction with cooperation with the U.S. government. Such action can profoundly affect the government's reaction and can mean the difference between completing and scuttling a deal.

4. Abandoned Merger. The abandoned merger between Lockheed and Titan highlights how the threat of FCPA liability can adversely affect a merger or acquisition. For companies with significant U.S. government-related business, FCPA violations may hold severe consequences, including criminal or civil judgments, which impair a company's ability to obtain government contracts. For Lockheed, a defense contractor, the risk of losing such contracts outweighed any benefits from merging with Titan. Further, Titan proved unable to dispose of the FCPA allegations, thereby canceling the merger. In this case, the threat of FCPA liability was so severe as to jeopardize, and in the end, scuttle the merger agreement.

5. Extensive Global Subsidiaries in New Markets. Acquiring companies seeking to purchase foreign businesses must conduct a thorough review of a target's foreign subsidiaries and foreign agents. For example, in *Tyco*, inadequate due diligence revealed only a general knowledge of illicit payments in the targets' countries and industries without uncovering specific illicit activity by the target. Such patterns of corruption serve as a red flag providing notice to the acquiring company. Acquiring foreign subsidiaries with an ongoing practice of improper payments requires immediate implementation of an effective FCPA compliance and training program on a global scale.

6. No Charges against the Acquiring Companies. In *Delta/Turk* and *York*, neither the DOJ nor SEC took enforcement action against the acquiring companies. The U.S. government noted the acquiring companies' cooperation in discovering FCPA issues in their pre-acquisition due diligence reviews, their voluntary disclosures, and immediate remedial efforts. The conclusion to be drawn, therefore, is that the agencies will exercise their enforcement discretion by not bringing charges against the acquirer for prior illicit activity where the acquirer has cooperated extensively and undertaken robust remedial steps.

7. IPO Due Diligence. While several recent FCPA cases have arisen from due diligence related to a merger or acquisition, *Paradigm* is the first reported case where misconduct was discovered during due dili-

gence in connection with an IPO. Consequently, companies engaged not only in mergers and acquisitions, but also in various types of strategic transactions must be alert to FCPA issues in the due diligence process.

8. Implications of Unresolved FCPA Liability. *Opinion Release 08-02* provides useful guidance for acquirers who cannot perform sufficient due diligence prior to the completion of an acquisition. The Release recognized the realities of time constraints, foreign legal impediments, and limited access to information from the target company as significant challenges to Halliburton in identifying FCPA risks. The DOJ, therefore, endorsed a pragmatic approach for Halliburton to proceed with the transaction. The Release highlights key due diligence components to protect acquirers from FCPA liability for a target's past violations, including a comprehensive, risk-based investigation utilizing a team of outside counsel and forensic accountants, a review of relevant financial and accounting records, key employee emails, employee interviews, and simultaneous self-disclosure of the investigation results to the DOJ. Further, the Release provides detailed elements of an adequate post-acquisition due diligence work plan, effectively allowing a 180-day post-closing grace period for FCPA misconduct disclosed to the DOJ. In addition, the Release emphasizes the critical need to remediate illicit activities by terminating relationships with employees and third-party intermediaries, entering into new contracts, and conducting effective compliance training.

Practical Steps for Pre-Acquisition Due Diligence

Every FCPA due diligence work plan must be tailored to the specific risks of the deal. However, as shown in the cases and the DOJ Opinion Release described above, companies may take certain basic measures to mitigate the risks of FCPA liability in the mergers and acquisitions context.

1. Assess the corruption level in the target's country, its subsidiaries' countries, and relevant industries.
2. Identify the target's business involving government officials and agencies. Review government contracts. Evaluate the target's business involving government licenses and permits.
3. Evaluate and review the company's use of consultants, representatives, agents, brokers and other third-party intermediaries. Review due diligence files and relevant agreements.
4. Review the target's anti-corruption policies and procedures.
5. Request information concerning any prior anti-corruption problems and investigations.
6. Analyze existing internal controls and perform a financial audit on the target's books and records. Review and sample selected accounts on the general ledger, including consultants, distributors, travel, entertainment and petty cash.
7. Include in the purchase agreement FCPA compliance and resolution of FCPA issues as conditions to closing.

8. Voluntarily disclose to the DOJ and SEC any past illicit activities before closing, cooperate with any U.S. government investigation, and outline remedial steps to implement immediately after closing.

Conclusion

FCPA pre-acquisition due diligence is a critical component for companies in the context of mergers and acquisitions. Properly identifying, disclosing, and addressing FCPA compliance issues prior to closing mitigates liability and strengthens compliance post-acquisition. However, failure to exercise proper FCPA due diligence can lead to significant liabilities for companies and can scuttle an otherwise valuable business transaction.