



# **Private Equity and the FCPA: What You Need to Know**

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# Presenters



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# Agenda

- **Why the FCPA Matters to Private Equity**
- **FCPA Primer**
- **Fundraising Stage**
- **Acquisition Stage**
  - Pre-Acquisition
  - Post-Acquisition
- **Exit Stage**
- **Compliance Tips**
- **Questions & Answers**

# WHY THE FCPA MATTERS TO PRIVATE EQUITY

# Increased Government Focus

- DOJ and SEC have made banking/finance industry a focus of FCPA enforcement efforts
- January 2011 – SEC investigations into bank and private equity firm relationships with sovereign wealth funds and foreign government employee pension funds
- Under Dodd-Frank Act, SEC empowered to investigate FCPA allegations and whistleblowers afforded greater protections

# Increased Public Attention



U.S. SEC examiner cites more problems in private equity sector Wed May 13, 2015 5:47pm EDT



**Recent Enforcement Trends Indicate Increased FCPA Peril for Private Equity Firms**  
November 1, 2011



Private equity has a whistleblower problem  
DECEMBER 2, 2013,



**SEC probes private-equity firms over alleged bribes**  
January 7, 2015

# Aggressive FCPA Enforcement

- Corporate FCPA settlements over past five years:
  - 2014: 10 settlements
  - 2013: 12 settlements
  - 2012: 12 settlements
  - 2011: 15 settlements
  - 2010: 23 settlements
- Individual FCPA settlements over past five years:
  - 2014: 10 individuals
  - 2013: 12 individuals
  - 2012: 2 individuals
  - 2011: 10 individuals
  - 2010: 33 individuals

# Significant FCPA Fines

- DOJ / SEC aggregate FCPA settlements over past five years:
  - 2014: \$1.56 billion
  - 2013: \$731 million
  - 2012: \$259 million
  - 2011: \$509 million
  - 2010: \$1.8 billion



# Significant Individual Liability

*“Since 2009, we have convicted more than 50 individuals in FCPA and FCPA-related cases, and resolved criminal cases against more than 50 companies with penalties and forfeiture of approximately \$3 billion.*

***Twenty-five of the cases involving individuals have come since 2013 alone.** And those are just the cases that are now public. These individuals run the gamut of actors involved in bribery schemes: corporate executives, middlemen, and corrupt officials.”*

**Assistant Attorney General Leslie R. Caldwell**  
**November 2014**

# FCPA Risks to Private Equity

- FCPA risk affects:
  - Your investments
  - Your legal risk for being held accountable for FCPA violations by portfolio companies
  - An accurate valuation of a portfolio company

# FCPA PRIMER

# Structure of the FCPA

## Antibribery Provisions

- Prohibits bribery of foreign government or political officials for the purpose of obtaining or retaining business or securing any improper advantage
- Mainly enforced as criminal violations by the Department of Justice

## Books and Records Provisions

- Requires SEC-registered or reporting issuers to make and maintain accurate books and records and to implement adequate internal accounting controls
- Mainly enforced as civil violations by the Securities and Exchange Commission

# To Whom Do the Antibribery Provisions Apply?

- Any “issuer” that files reports to the SEC or trades equity or debt on a U.S. exchange
  - Includes any foreign company that trades, for example, American Depository Receipts (ADRs) on a U.S. exchange
- Any “domestic concern”
  - Includes U.S. citizens, nationals, and residents as well as any entity (corporation, partnership, etc.) that is organized under the laws of the U.S. or a U.S. territory or that has its principal place of business in the United States
- Any “person,” including an organization, wherever located, that, while in a U.S. territory, does any act in furtherance of the prohibited conduct
  - Government argues minimum contacts include emails, telephone calls, transfers through correspondent bank accounts in U.S. intermediary banks

# Antibribery Prohibited Acts

- It is unlawful for
  - an “issuer,” “domestic concern,” or “any person acting within the territory of the United States”
  - with “corrupt intent”
  - directly or indirectly
  - to offer, pay, promise to pay, or authorize payment
  - of “anything of value”
  - to a “foreign official”
  - for the purpose of obtaining or retaining business

# Facilitation Payments

- Applies **ONLY** to expedite or secure performance of “routine governmental” action by a government official
  - Must be non-discretionary and not a misuse of discretion
  - Size is not determinative, but can suggest discretion or corruption – look to purpose rather than its value
- **Examples**
  - Obtaining permits, licenses, or other official documents
  - Processing governmental papers, such as visas and work orders
  - Providing police protection
  - Mail pick-up and delivery
  - Providing phone service, power, and water supply
  - Loading and unloading cargo
  - Protective perishable products
  - Scheduling inspections associated with contract performance in transit of goods across country
- **BUT** some companies no longer allow these types of payments
- **AND** facilitation payments are not always permitted under local foreign law

# “Affirmative Defenses” Under the FCPA

- “Lawful” under local law
  - The fact that bribes may not be prosecuted under local law does not suffice for this defense
  - *U.S. v. Kozeny* (S.D.N.Y. 2008): court ruled that an exception under Azeri law that relieved bribe payors who voluntarily disclosed bribe payments to the authorities of criminal liability did not make the bribes legal under this affirmative defense
- Promotional payments
  - “Reasonable and bona fide” expenses
    - Promotion, demonstration, explanation of products/services
    - Execution of performance of contract
  - Proper documentation of expenditures



# Books and Records

- Books, records, and accounts must be kept “in reasonable detail”
  - Level of detail that would satisfy prudent officials in the conduct of their own affairs
  - No materiality threshold
  - Bribes are often concealed as legitimate payments, such as consulting fees, marketing expenses, travel and entertainment, or discounts
- System of internal accounting controls
  - The processes in place to ensure accurate financial reporting
  - Includes the organization’s “tone,” risk assessments, and control activities such as approvals, authorizations, segregation of duties, etc.
  - An effective compliance program is a critical component of internal controls
- SEC will look to see if there are potential reporting and anti-fraud violations that accompany the FCPA violation
- There can be criminal liability for accounting violations

# Penalties

- Civil and criminal penalties
- Jail time for individuals
  - Up to 5 years for anti-bribery violations
  - Up to 20 years for books & records violations
- Massive fines
- Corporate monitors
- Director & officer bars
- Damage to reputation

# FUNDRAISING STAGE

# Who is a “Foreign Official”?

- Any foreign government employee
- Foreign political parties, party officials, and candidates for political office
- Any employee of a state-owned or controlled enterprise

# Foreign Officials: Concerns for Private Equity

- Sovereign Wealth Funds
  - August 2011: Goldman Sachs investigated by SEC for dealings with Libyan Investment Authority
- State-Owned Enterprises or State Controlled Entities
- Foreign Government Employee Pension Funds
- Joint Ventures with any of these funds or entities

# Third Party Agents

- Use of third-party intermediaries, agents, brokers, consultants is consistently a large risk area for many companies doing business in foreign countries
- Principal can be held directly liable for improper payments made by third party, even without actual knowledge

# Third Party Agents: Concerns for Private Equity

- FCPA liability extends to third-party agents and representatives acting on a private equity firm's behalf
- SEC (and Serious Fraud Office in UK) have focused on placement agents arranging opportunities with sovereign wealth funds and foreign national pension funds
- Best Practices:
  - Due diligence on placement agents and finders used in foreign countries remains critical
  - Commissions must be reasonable and transparent

# ACQUISITION STAGE



# Pre-Acquisition

# Due Diligence & Risk Assessment

- DOJ / SEC advise conducting risk-based FCPA due diligence to assess target company's anti-corruption risk
  - Geography
  - Industry
  - Foreign government interactions (customs, taxation, licenses)
  - State-owned enterprises as customers
  - Use of Third Party Agents
  - Expense review (travel, entertainment, marketing, gifts)
  - Assess target's current compliance program
- Reasons:
  - FCPA risks may be too significant to proceed
  - Affects appropriate valuation of target company
  - Avoid “buying into” a target company's risk

# Failure to Conduct Due Diligence: eLandia Acquisition of LatiNode

- eLandia failed to conduct robust due diligence during deal negotiations
- After acquisition, eLandia discovered LatiNode had FCPA violations involving over \$500,000 in bribes to Honduran / Yemeni state-owned telephone companies
- LatiNode paid \$2 million fine and former LatiNode executives faced criminal penalties
- eLandia:
  - Disclosed violations to DOJ and cooperated
  - Allocated \$18.2 million of \$22.3 million purchase price as charge against income to cover FCPA penalties and investigation costs

# Ownership & Control

- No bright line rules for levels of ownership and control that will trigger FCPA risk
- Elements of Control
  - Majority ownership
  - Majority voting power on Board
  - Minority ownership, but ability to control Board decisions
- Risk of liability for FCPA violations increases with more ownership or control of portfolio company
- Best practice is for PE firm to adopt an anti-corruption policy that identifies ownership/control thresholds for conducting varying due diligence levels

# Willful Blindness: Frederic Bourke's Investment Consortium

- Private equity firms cannot turn a blind eye to improper conduct
- Bourke invested in foreign company seeking to privatize SOCAR, a Azerbaijan-owned oil company
- Witnesses testified that Bourke was aware of bribes to government officials
- Theory: Though Bourke lacked operational control, he consciously avoided the bribery scheme
- Found guilty of conspiracy to violate FCPA; sentenced to one year and one day in prison

# Successor Liability Knowledge Requirement

- Imputed Knowledge: Omega Advisors Settlement (2007)
  - Former Omega Advisors employee admitted to knowing that an investment opportunity related to a privatization program in Azerbaijan was secured by illegal bribes
  - Omega settled with DOJ; required to pay \$500,000
- “Control Person”: Nature’s Sunshine Products (2009)
  - SEC settled with the company, CEO, and former CFO
  - CEO and CFO had no personal knowledge of cash payments to customs officials by company’s Brazilian subsidiary
  - Liability premised on Section 20(a) of the Securities Exchange Act of 1934 (status as control persons)

# Successor Liability: Liability Not Created Through Acquisition

- No liability where none existed before
  - No FCPA liability for pre-acquisition potential FCPA violations by foreign target company if target company not already subject to FCPA
  - Acquisition does not transform target company to “create liability where none existed before”
- DOJ Opinion Procedure Release No. 14-02 (November 2014)

# FCPA Representations & Indemnification

- If acquiring a minority ownership share or lack of controlling interest, seek inclusion of a provision allowing for indemnification if FCPA violations are detected or reported
  - Pursue no deductible and no liability cap for losses occurring at portfolio company and full indemnification for losses to the PE fund
- Goal:
  - Protect your investment
  - Provide some assurance that seller has conducted its own thorough due diligence and has implemented a strong compliance program and internal controls



# Voluntary Disclosure

- No requirement for buyers or sellers to voluntarily disclose FCPA violations
- SEC & DOJ encourage companies in M&A context to voluntarily disclose target company's violations and remediate conduct
  - Suggests “meaningful credit” provided to companies who disclose and remediate

# Voluntary Disclosure In Deal Negotiations: General Electric / InVision Technologies

- GE in discussions to acquire InVision
- Deal due diligence revealed Invision bribes of \$203,000:
  - Payment to sales agent \$108,000 to obtain contracts from Filipino government officials
  - Payment to another agent \$95,000 to induce Chinese officials to reduce a financial penalty
- Invision and GE agreed to voluntarily disclose Invision's improper conduct and subsequent internal investigation findings to DOJ
- Penalties: \$1.1 million (disgorgement: \$589,000; prejudgment interest: \$28,000; civil penalty: \$500,000)

# Post-Acquisition

# Compliance Integration & Development

- DOJ / SEC have advised that an acquiring company should immediately begin integrating a target company into its own compliance culture
  - Adopt the acquiring company's code of conduct
  - Implement the acquiring company's FCPA policies & procedures
- Best practice is for a PE firm to adopt its own FCPA policy that sets forth procedures for rolling out compliance integration to a portfolio company upon acquisition

# Training

- DOJ / SEC advise instituting training on FCPA and acquiring company's policies and procedures to a target company's:
  - Directors
  - Officers
  - Employees
  - Third-party agents and business partners

# Audit of FCPA Practices

- DOJ / SEC advise that acquiring companies should conduct an FCPA-specific audit of target company as quickly as practicable after closing
  - Scope of audit will vary depending on business (high-risk countries, state-owned enterprise customers, use of foreign third-party agents, interactions with government officials)
  - Extent of due diligence during deal negotiations
- High risk for PE firm if portfolio company made improper payments to secure contracts that remain in place at time of closing
- DOJ / SEC advise that acquiring company disclose any corrupt payments discovered as part of audit process

# Internal Controls

- Implement process for compliance concerns to be reported and investigated by the portfolio company in order to reduce whistleblower risk
- Should be tailored to the nature of a specific portfolio company's business

# Board Involvement & Placement

- Placement of board members with portfolio company exposes the PE firm to increased risk
- Collective knowledge of board can create liability to PE firm for FCPA violations
- Applies even with minority investment or lack of board control



# Whistleblower Complaints

- Dodd-Frank Act
- Risk of Whistleblower Complaints
  - PE firm personnel
  - Employees at portfolio companies
  - Third party agents/representatives
- More than 3,000 whistleblower tips filed each year
  - Awards to compliance personnel
  - Awards to foreign whistleblowers
  - Whistleblowers being represented by *qui tam* plaintiffs law firms

# EXIT STAGE

# Protect Your Investment

- Maintain portfolio company's value
- Effectively position company for sale
- Attract potential buyers
- Prevent buyers from gaining leverage
- Reduce due diligence burden

# Reduce Your Risk

- Deal
- Criminal
- Civil
- Reputational

# COMPLIANCE TIPS

# Compliance Programs

- One size does not fit all
- Requires a careful analysis and an intentional identification of risks for:
  - Your firm
  - Your portfolio companies

# Essential Elements to Compliance Program

- Tone at the top – commitment from senior management and clearly articulated policy against corruption
- Code of conduct, compliance policies & procedures
- Oversight, autonomy, and resources
- Risk assessment
- Training and continuing advice
- Incentives and disciplinary measures
- Third-party due diligence
- Confidential reporting and internal investigation

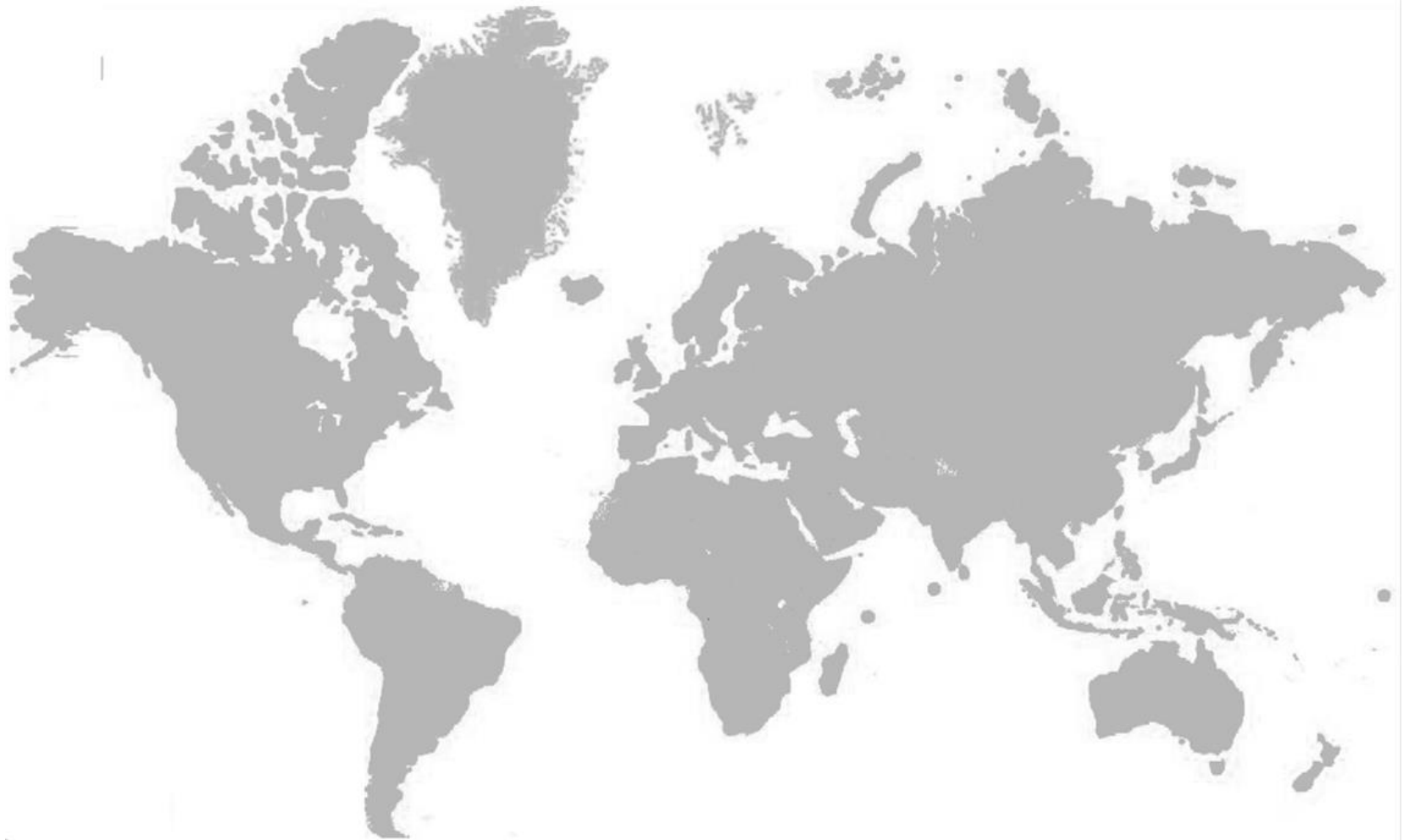
# Mergers & Acquisitions

- DOJ continues to emphasize importance of effective anti-corruption due diligence in deal context
- DOJ/SEC urge the following:
  - Pre-Acquisition Due Diligence
  - Post-Acquisition Compliance Integration
  - Anti-Corruption Training
  - FCPA Audit
  - Disclosure to Government

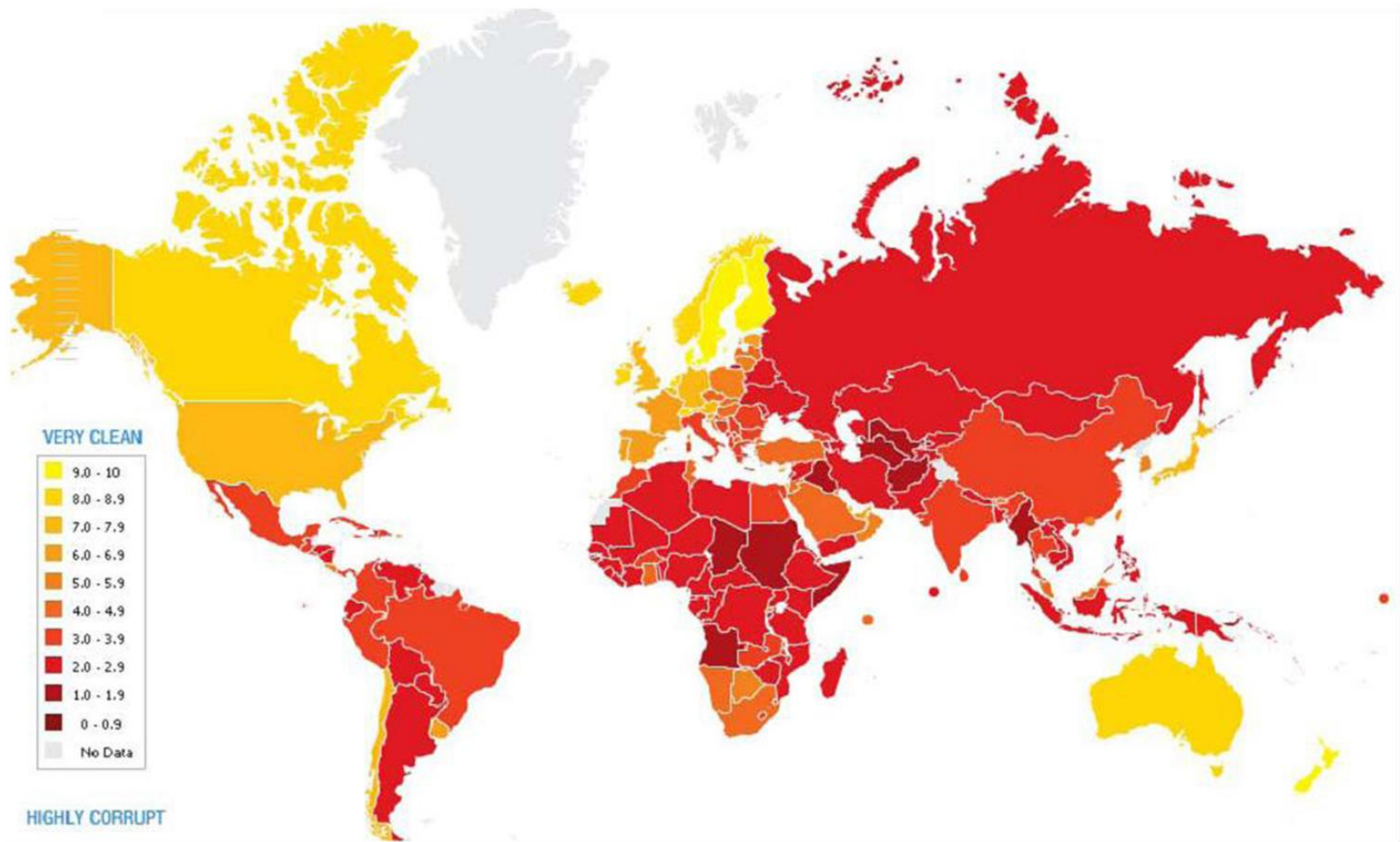


# CONCLUSION

You see...



# Prosecutors see...



# QUESTIONS & ANSWERS

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# BRYAN CAVE

The logo for Bryan Cave, featuring the words "BRYAN CAVE" in a bold, dark blue, sans-serif font. A thick, light green curved line sweeps across the bottom of the letters, starting under the 'B' and ending under the 'E'.

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