



ANTI-BRIBERY DUE DILIGENCE FOR TRANSACTIONS

GUIDANCE FOR ANTI-BRIBERY
DUE DILIGENCE IN MERGERS,
ACQUISITIONS AND INVESTMENTS

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TEN GOOD PRACTICE PRINCIPLES FOR ANTI-BRIBERY DUE DILIGENCE IN MERGERS, ACQUISITIONS AND INVESTMENTS

Internal policies and procedures

1. The purchaser (or investor)¹ has a public anti-bribery policy.
Comment: This will provide a reference point for the due diligence approach and also specific protection for the due diligence process - for example, in helping to ensure that no bribe should be made to obtain information or speed up the transaction, either directly or through a third party.
2. The purchaser ensures it has an adequate anti-bribery programme that is compatible with the Business Principles for Countering Bribery or an equivalent international code or standard.

Due diligence – pre acquisition

3. Anti-bribery due diligence is considered on a proportionate basis for all investments.
Comment: This includes M&A transactions, acquisitions of businesses, private equity investments and other forms of investment.
4. The level of anti-bribery due diligence for the transaction is commensurate with the bribery risks.
Comment: The level of bribery risk should be determined at the start of the process. This will be to ensure that the due diligence is conducted with sufficient depth and resources to be undertaken effectively.
5. Anti-bribery due diligence starts sufficiently early in the due diligence process to allow adequate due diligence to be carried out and for the findings to influence the outcome of the negotiations or stimulate further review if necessary.
6. The partners or board provide commitment and oversight to the due diligence reviews.
Comment: The findings of anti-bribery due diligence should be properly examined and understood at the highest level of decision-making during the transaction, for example at the level of the board or investment committee.
7. Information gained during the anti-bribery due diligence is passed on efficiently and effectively to the company's management once the investment has been made.
Comment: For example, information about the adequacy of the anti-corruption procedures in the target company should be used to initiate remedial action.

Due diligence – post acquisition

8. The purchaser starts to conduct due diligence on a proportionate basis immediately after purchase to determine if there is any current bribery and if so, takes immediate remedial action.
Comment: Gathering sufficiently detailed information is one of the challenges of anti-bribery due diligence. Where this has not been possible pre-closure, a full due diligence should be carried out within a set time period post-completion.
9. The purchaser ensures that the target has or adopts an adequate anti-bribery programme equivalent to its own.
10. Bribery detected through due diligence is reported to the authorities.
Comment: This principle is based on the presumption that bribery discovered during due diligence should be reported to the authorities. Purchasers may use their discretion, bearing in mind factors such as proportionality in reporting, the deal timetable and their own legal obligations, but it is in their interest to report to authorities as in this way they can discuss the issue and establish how the bribery could affect the deal.

1. Hereafter referred to as 'the purchaser'

1. INTRODUCTION

This guidance relates to mergers and acquisitions (M&A), private equity investments and other forms of investment. The definitions used in this guidance are:

Transaction: merger, acquisition or investment

Target: a company that is a target for merger acquisition or investment

Purchaser: the company making a merger, acquisition or investment of any size

Purpose of this guidance

Anti-bribery due diligence can help purchasers to manage their investment risk in transactions more effectively. However, it is often not undertaken, neglected, or allocated insufficient time and resources. A recent survey found that:

“Despite the many recent examples of the perils of ignoring the fraud and corruption dimension of these assessments, a fifth of companies still do not consider it as part of M&A due diligence, and a quarter never consider it in a post-acquisition review.”²

This guidance is intended to provide a practical tool for companies on undertaking anti-bribery due diligence in the course of mergers, acquisitions and investment. It reflects the approach for corporate anti-bribery programmes set out in the Business Principles for Countering Bribery³, which is an anti-bribery code widely recognised as an international benchmark for good practice, and developed in close consultation with companies and other stakeholders. This guidance is provided in the context of three overarching considerations:

- Anti-bribery due diligence should be applied to all investments but on a risk-based approach, with the level of due diligence being proportionate to the investment and the perceived likelihood of risk of bribery.
- In many cases the necessary information for due diligence may not be accessible, such as in acquisition of public companies, hostile take-overs, auctions or minority investments. This does not obviate the need for anti-bribery due diligence, but has an effect on the timing – i.e., it may need to be undertaken post-closure.
- A good practice approach characterises ethical and responsible businesses, but is also the most effective means for companies to manage bribery risks across multiple jurisdictions and in a changing legal and enforcement environment.

There are three intended audiences for this guidance:

- Companies that are considering or are undertaking a merger, acquisition or investment (hereafter referred to as a transaction);
- Companies that may be subject to due diligence, as companies positioning themselves to be acquired must also prepare themselves to be ready to meet the standards required in anti-bribery due diligence; and
- Professional firms and advisers that are involved in transactions and related due diligence.

A good practice approach is the most effective means for companies to manage bribery risks across multiple jurisdictions and in a changing legal and enforcement environment

2. *Driving ethical growth – new markets, new challenges, 11th Global Fraud Survey, Ernst & Young, 2011*

3. www.transparency.org

The broad principles and approaches to anti-bribery due diligence apply both to M&A transactions and private equity investments, and this guidance is therefore written for both audiences

The broad principles and approaches to anti-bribery due diligence apply both to M&A transactions and private equity investments, and this guidance is therefore written for both audiences. However, the type of transaction and the size of the stake will clearly have an effect on the purchaser's ability and resources to undertake due diligence, its assessment of investment risks accruing from bribery, and its ability to access and influence the target company.

This guidance provides a generic framework for applying due diligence, but purchasers will need to decide in each case what level of due diligence is appropriate. Some targets will be judged to present low risks and to require lower levels of due diligence whereas others will have higher risks. The size of investment should not be a determining factor as small investments can carry disproportionate risks; and moreover the material risks attached to bribery may not necessarily reflect the size of the bribe.

A good practice approach is that the level of due diligence is proportionate to the bribery risks; however, the effectiveness of a risk-based approach depends on an adequate understanding of the risks, which may easily be overlooked due to factors such as pressure of time, poor quality information or members of the deal team being insufficiently experienced. A proper assessment of what is proportionate can only be made if the risks are properly understood. This in itself will require an early-stage allocation of resources and a genuine commitment to make an effective assessment.

What to look for in anti-bribery due diligence

- Has bribery taken place historically?
- Is it possible or likely that bribery is currently taking place?
- If so, how widespread is it likely to be?
- What is the commitment of the board and top management of the target to countering bribery?
- Does the target have in place an adequate anti-bribery programme to prevent bribery?
- What would the likely impact be if bribery, historical or current, were discovered after the transaction had completed?

A changing environment

Deal-making can take place across multiple jurisdictions, and purchasers are faced with a changing legislative environment exemplified by the UK Bribery Act 2010 and new anti-bribery laws in Russia and China. Increasing enforcement in several jurisdictions, and most notably of the FCPA in the United States, presents heightened risks of criminal and civil penalties for individuals and companies. In 2010, companies settling FCPA-related charges in 2010 paid a record \$1.8 billion in financial penalties to the DOJ and SEC compared to \$641 million in 2009 and \$890 million in 2008.

Almost 50% of US corruption-related prosecutions in 2007 were connected to M&A transactions.

In addition to legislation, there are changing expectations by stakeholders including governments, regulators, institutional investors, consumers, the media and civil society. Growing demands for integrity, responsibility, accountability and transparency are transforming the environment for purchasers and investors.

The UK's Serious Fraud Office (SFO) has made several statements about the responsibilities and liabilities of private equity and institutional investors – for example, in January 2012 it said: "Shareholders and investors in companies are obliged to satisfy themselves with the business practices of the companies they invest in.... It is particularly so for institutional investors who

Almost 50% of US corruption-related prosecutions in 2007 were connected to M&A transactions

Companies positioning themselves to be acquired must also prepare themselves to be ready to meet the standards required in anti-bribery due diligence

have the knowledge and expertise to do it. The SFO intends to use the civil recovery process to pursue investors who have benefitted from illegal activity. Where issues arise, we will be much less sympathetic to institutional investors whose due diligence has clearly been lax in this respect."⁴

Deal flows are also changing, with M&A activity and private equity investments increasingly taking place in emerging markets where corruption is known to be prevalent. In the other direction, companies from the emerging nations are ever more active in purchases of companies from developed countries and must beware the attention of regulators. Companies positioning themselves to be acquired must also prepare themselves to be ready to meet the standards required in anti-bribery due diligence.

Challenges of anti-bribery due diligence

Combined with the higher expectations being placed on purchasers with regard to due diligence, there are also significant challenges in carrying out due diligence.

One such limitation in carrying out due diligence is that information is often just not available as the target, even in a friendly acquisition, may be reluctant to provide or not have sufficient information or if a public company, there may be restrictions on what can be provided. Where there is a hostile acquisition or purchase through an auction, the purchaser may not be able to gain access to all necessary information. In such circumstances, the purchaser will have to rely on the limited available information before acquisition, judge whether to proceed and then carry out immediate and thorough due diligence after the acquisition is completed.

Other challenges may include time pressure, lack of senior management support and insufficient expertise in the deal team. A further pressure in some transactions may be because of a flawed assessment of cost: senior managers who do not understand the risks adequately may be reluctant to commit human and financial resources to an area that they may view as relatively unimportant.

Proceeding cautiously if bribery is suspected

In the event that due diligence identifies evidence of past or current bribery, this does not necessarily mean that the purchase should be aborted. Indeed, there can be a net benefit if a company with an anti-bribery culture takes over a company with a less rigorous approach. The prospective purchaser may be able to agree with the enforcement authorities a grace period, following acquisition, during which agreed mitigation steps are carried out.

⁴ SFO press release of 13 January 2012 – 'Shareholder agrees civil recovery by SFO in Mabey & Johnson'

2. INVESTMENT RISK AND THE ROLE OF ANTI-BRIBERY DUE DILIGENCE

The Purchaser's board members, senior management and investment committees should seek to develop a full understanding of bribery risks related to target companies during transactions in order to understand the *investment risk*. The nature of the investment risk from bribery falls into four broad areas:

- Financial: the financial data may be distorted or falsified, e.g., the target's sales figures may be inflated by contracts obtained through bribe-paying;
- Legal: there may be inheritance of legal risks e.g., the purchaser may incur liability, leading to fines and regulatory action;
- Reputational: for example, the purchaser may find that, owing to publicity surrounding a poor acquisition, it is regarded as a less favourable partner or investment vehicle by others, including institutional investors; and
- Ethical: purchasing companies, or acquiring individuals within those companies, that are willing to engage in bribery, risks infecting the ethical culture of the purchaser and having a deleterious effect on the organisation. A corrupt target may introduce dishonesty and corruption to the purchaser's own activities.

Bribery risk is a general term used to describe the likelihood that bribery has been, or continues to be, present in any aspect of a target's business practices. The due diligence process is designed to discover, or determine the likelihood of, both current and historical bribery in the target company. The due diligence may reveal this either during the transaction or post-closure.

There is a distinction between *inherent bribery risk* and *residual bribery risk*. Inherent risk exists in all geographies, all sectors and all transactions, but to a degree that varies according to factors such as the frequency with which bribes are typically paid in a particular country, sector or type of transaction. The residual bribery risk is the remaining risk after steps have been taken to mitigate the inherent risk. What is important, therefore, is to identify the inherent risks within the business being acquired and to understand what, if anything, the target does to minimise and manage the risks. The residual bribery risk is ultimately the key matter for the acquirer to consider.

While it is likely that much anti-bribery due diligence will be driven by compliance with legal obligations, it is important to recognise that taking a good practice approach is the best way to counter the risks of legal liabilities and the financial and reputational damage that may come from purchasing or investing in a company associated with bribery. Following good practice should also help companies to be compliant with the provisions of anti-bribery legislation in the multiple jurisdictions in which they operate including the UK Bribery Act and US Foreign Corrupt Practices Act (FCPA).

There are typically additional benefits of conducting anti-bribery due diligence over and above the direct benefits of bribery risk management:

- Management quality indicator: purchasers and investors, when conducting evaluation, should assess the positive qualities of the target including the excellence of management and its systems. Evidence from due diligence of a good practice and effective anti-bribery programme is an indicator of management quality;

The due diligence process is designed to discover, or determine the likelihood of, both current and historical bribery in the target company

- Mitigation benefit: evidence of good practice due diligence could form part of a plea for mitigation in the event of a post-completion bribery incident or investigation of the target by the authorities;
- Reputational gain: a purchaser or investor may enhance its reputation with the target, regulators or its own investors if it shows integrity, responsibility and thoroughness during diligence; and
- Meeting investor expectations: a purchaser's or investor's limited partners and investors may seek assurances that purchasers or investors are addressing Environmental, Social and Governance risks, including bribery, during transactions.

Potential consequences of bribery in a target company

Investments made in companies that have committed or are at continuing risk from bribery are more risky investments for a number of reasons:

- The target or purchaser may face criminal, civil and financial sanctions
- Corrupt partners are unreliable and may be involved with or obligated to dubious entities and people
- Deals are at great risk of collapse
- Market value may be distorted
- Associates of the target may make a purchaser liable to investigation and prosecution
- A corrupt target may introduce dishonesty and corruption to the purchaser's own activities.

The consequences of bribery in a target company can include:

- **Diminished asset value and returns**
 - Reduced investment and portfolio valuations
 - Acquisition of an overvalued asset
- **Investigations and convictions**
 - Criminal, civil and financial proceedings against the company
 - Stringent settlement agreements
 - Appointment of court monitors
 - Diversion of management and board time
 - Extensive professional fees
- **Business instability**
 - Aborted deals
 - Reputational damage and media attention
 - Acquired business proves dysfunctional
 - Diminished exit opportunities
 - Debarment from government contracts
 - Director disqualification
 - Regulatory authority restrictions
 - Employee de-motivation
 - Loss of key people in investee companies if they are involved in bribery or convicted of an offence
- **Liability of directors, partners and officials**
 - Criminal and civil penalties
 - Debarment from office
 - Professional damage
- **Media attention**

3. THE DUE DILIGENCE PROCESS

This section outlines how anti-bribery due diligence can be integrated into standard due diligence procedures during M&A or investment activity.

SIGNPOST

Care should be taken that bribery does not take place during the investment or acquisition process itself. Such transactions can be particularly vulnerable to bribery owing to factors such as tight deadlines, the desire to obtain information, use of third parties and intermediaries, interaction with public officials over licensing, or attempts by third parties to gain access to insider information.

3.1 THE AIMS OF DUE DILIGENCE

The core aims of anti-bribery due diligence are:

- Assuring that the business to be acquired is sound and not distorted by bribery, and its apparent business value is not a product of bribery; this will include:
 - Identifying the inherent risks of bribery for the target based on indicators such as countries of operation and markets;
 - Assessing those risks particular to the target including organisational structure, integrity of the board, key managers and shareholders, and use of third parties, such as agents;
 - Assessing the adequacy of the target's anti-bribery programme with particular attention paid to risks identified in the due diligence, and thereby assessing its residual risks;
- Identifying early in the due diligence process, any bribery exposure that could cause the deal to be aborted or modified – it is better to do so earlier than later;
- Checking there will not be potential successor risks or inherited liability from bribery with resultant criminal and/or civil penalties, loss in business value and other consequences;
- Providing a basis for mitigating penalties in the event of a bribery violation by showing there was adequate due diligence;
- Providing a basis for monitoring the target once acquired to ensure the quality and effectiveness of its anti-bribery programme.

3.2 ORGANISING THE PURCHASER FOR DUE DILIGENCE

3.2.1 Due diligence policies and procedures

Anti-bribery due diligence is most effective when the purchaser itself has in place an anti-bribery programme, of which due diligence is a part. As part of its own anti-bribery programme, the purchaser should therefore establish risk-based policies and procedures for due diligence and draw on experience to improve the process.

3.2.2 Tone from the top

The 'tone from the top' is important as the starting point for effective anti-bribery due diligence. Without a commitment to anti-bribery standards, the purchaser will be sending mixed messages to those engaged in due diligence, probably leading to lack of rigour in the process. Similarly, mixed or weak messages may be sent to professional advisers and targets. Once a target has

Anti-bribery due diligence is most effective when the purchaser itself has in place an anti-bribery programme, of which due diligence is a part

been identified for potential purchase or investment, before starting the due diligence process, senior management should make a high-level review of the target and the potential bribery risks. The tone from the senior management should set the context for the due diligence process and ensure that the required attention and support is given to the process and allocate appropriate resources.

3.2.3 Internal team

Effective due diligence requires responsibilities and reporting lines to be clearly assigned, with good communication and coordination built into the process from the start. An individual should be appointed within the due diligence team with specific responsibility for anti-bribery due diligence. Depending on the nature of the target and transaction, this may require a supporting team of internal and external anti-bribery experts and others in relevant positions. The roles for those involved in due diligence will depend on the size of the purchaser and the scale and circumstances of the target.

The shortcomings of a target organisation's anti-bribery compliance framework often lie in the implementation of the programme rather than the design of policies and procedures. The expertise required to lead the due diligence should therefore require someone with good practical knowledge and experience of the effective implementation of anti bribery programmes, and knowledge of how bribes are and can be perpetrated.

The purchaser should define how the anti-bribery due diligence team will communicate and coordinate and designate responsibilities for sign-offs by management, the investment or portfolio management committee, partners or the board.

3.2.4 External advisers

Although some companies have in-house resources, in certain transactions the purchaser may rely heavily on external advisers in carrying out due diligence – these can include legal, accounting and other forensic outside advisers that offer specialist anti-corruption services. Legal advisers will wish to ensure that their report is legally privileged. A legal due diligence and an anti-corruption due diligence report can be combined or may sit separately. Where the purchaser uses external resources to assist with this aspect, it is essential that it ensures it engages ethical third parties, and that the purchaser has control over the activities carried out on its behalf.

3.2.5 Internal approvals

The board or partners of the purchaser would typically be responsible for the approval of the investment to proceed, directly or by delegation. As such, they will be responsible ultimately for ensuring that their own company has implemented adequate anti-bribery due diligence procedures during the transaction. They should receive the investment and due diligence reports and will need to review these carefully and question management as necessary to check that due diligence has been carried out to a proper extent in assessing bribery risks.

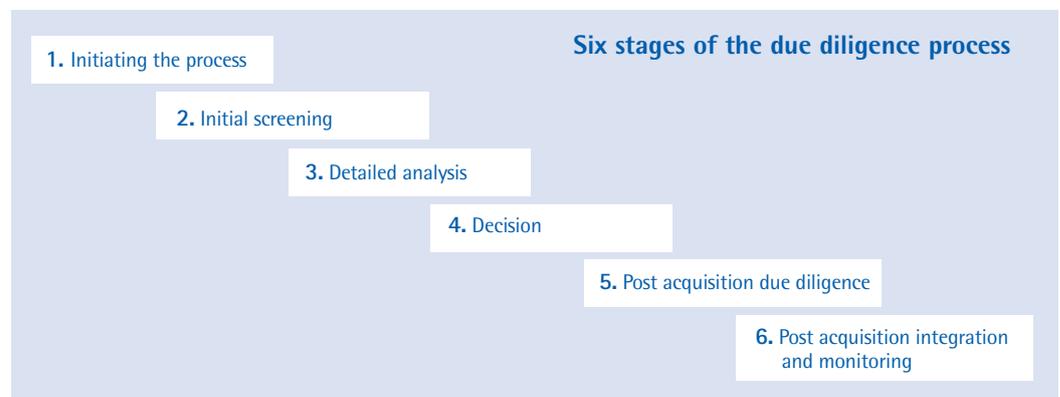
3.3 INTEGRATING ANTI-BRIBERY DUE DILIGENCE INTO THE PROCESS

Anti-bribery due diligence needs to be integrated from the start in the process to run alongside legal, financial and other due diligence. Effective integration and coordination will depend on a tone from the top of the organisation that makes clear the importance of anti-bribery due diligence. Coordination is necessary throughout the due diligence process so that the teams and advisers share knowledge and work closely together, leading to a greater probability of risks being identified and avoiding work being duplicated or omitted. Each function will have its own check-lists and research results and these should be aligned and shared.

Anti-bribery due diligence needs to be integrated from the start in the process to run alongside legal, financial and other due diligence. Effective integration and coordination will depend on a tone from the top of the organisation that makes clear the importance of anti-bribery due diligence

A due diligence process that follows a model template (which in practice rarely occurs) comprises six stages from the initiation of the idea to purchase to post-completion monitoring of the investment. The level of information obtained from the target is likely to influence the timing of the purchaser's ability to undertake anti-bribery due diligence. In the pre-signing period the purchaser must rely on the willingness of the target to provide access and even where there is a good relationship, there may still be constraints on what is provided. The opportunity to obtain information may increase at the signing of agreements and before closure of the deal but even then disclosures agreed as part of the signing may be limited having been negotiated at a competitive stage.

It is only after closure that the purchaser will have full access and in the event that bribery issues are discovered at this stage will need immediate resolution and may involve discussion with the authorities. Thus, however undesirable, due diligence on acquisitions must often be made on the basis of incomplete information and effective risk assessment and mitigation will rely heavily on the post-acquisition due diligence.



STAGE 1: INITIATING THE PROCESS

The process begins with a review by management to establish the scope and depth of the due diligence. Research, data collection and evaluation start at the second stage and continue throughout the stages until preparation of the report for approval.

Senior management will need to consider the likelihood of obtaining the necessary information and what should be the approach in such a case. Even if there is cooperation from the target, there may be constraints on what is provided, for example due to takeover regulations. The due diligence process may also be limited by the practicalities of gaining access to management and records. Therefore, where pre-closure due diligence is limited, post-acquisition anti-corruption due diligence is critical as this will enable the purchaser to review to a necessary scope and depth.

SIGNPOST

Make sure that anti-bribery due diligence starts at the beginning of the due diligence process; often it is left until the late stages which can have severe consequences – for example, a significant bribery issue may be discovered that endangers the investment or pressure to complete may lead to cutting corners.

Initial actions once the due diligence process is initiated

1. A manager is appointed to lead the anti-bribery component of the overall due diligence process. The manager should have the necessary expertise in finance and business case evaluation as well as practical experience of anti-bribery programmes and will, if appropriate, put together a team of internal and external experts.
2. The anti-bribery due diligence team make an initial assessment of the target's bribery risks in order to make the case about what resources will be needed and what level of due diligence will be proportionate to the apparent risks.
3. The acquisition team communicates the launch of the project to the relevant internal teams and external advisers along with the expectation that they will cooperate in the anti-bribery due diligence.
4. At the initial meetings held with the internal teams and advisers, the anti-bribery component of the due diligence is given proper consideration alongside other aspects of due diligence. The initial meetings should include a cross-functional meeting.
5. A timetable with milestones is developed - the time allocated for completion will vary widely with each situation but adequate time should be allocated to the anti-bribery due diligence.
6. The information needed for anti-bribery due diligence is scoped and prioritised. This will mean making judgements on what is vital and what is 'nice to have', by striking a balance between the time schedule, resources available for due diligence, the target's willingness to undergo detailed scrutiny, and the need to ensure that issues are not overlooked.
7. A decision is made on the period to be reviewed for the anti-bribery due diligence. No absolute guidance can be given on the period but the purchaser will take into account among others, relevant statutes of limitation and the nature of the target's business e.g. the due diligence would look back further in a business engaged in major construction contracts than a retail business. A typical period for review might be three to five years.

STAGE 2: INITIAL SCREENING

SIGNPOST

Don't rely upon someone else's due diligence work. Risk approaches and risk circumstances are never the same. Each transaction is a fresh start.

This phase comprises initial external screening and first discussions will also be held with the target to:

- Understand its anti-bribery approach and programme and willingness to share information.
- Assess the commitment of the target's board and leadership to integrity and the target's anti-bribery programme.
- Identify any apparent significant exposures or risks related to bribery and discuss these with the management of the target.
- If the risks are high and remediation does not seem an option, this may lead to the proposed investment being dropped at this first stage before deeper due diligence is undertaken.

Factors related to corruption risk that can contribute to a decision not to proceed can include:

- Current investigations by the authorities involving the target;
- Lax management;
- Poor internal controls when operating in countries and sectors with high risks of corruption;
- Dependence on key associated persons known to be of poor or questionable integrity.

The acquisition team may carry out this phase through internal resources or by appointing an external adviser such as a legal firm, forensic accountant or a risk consultancy that specialises in anti-corruption work. The work can include asking the external advisers to undertake discreet checks on local and sector sources to determine if there are any potential bribery issues related to the target.

SIGNPOST

For an initial screening, the target can be sent an anti-corruption questionnaire in which it is asked to answer relevant questions e.g., where the company does business, its use of intermediaries, government officials

STAGE 3: DETAILED ANALYSIS

The detailed review is carried out to a degree that is proportionate with the bribery risks

At this stage the detailed review is carried out, to a degree that is proportionate with the bribery risks. If an M&A, the parties, unless it is a hostile bid, would have agreed in principle that a deal should be pursued. This may be formalised in a term sheet where a preliminary understanding of the terms of the deal will have been reached, but before the signing of a binding contract. Much of the detailed examination will be done remotely online and by telephone with access to a virtual data room. Additionally, in some instances there will be the wish or necessity to visit countries of operation or the physical data room. It is likely that there will be restrictions on access to the target's information and data unless concerns or issues are identified which demand that full information be supplied.

As this stage may involve substantial detailed and specialist examination of the target, consideration may be given to appointing appropriate experts specialising in anti-bribery investigation and relevant legislation including the UK Bribery Act and the US FCPA. In certain transactions it is common for some or all of these activities to be carried out by the purchaser's external advisors.

SIGNPOST

Much can be learnt from assessing the target's tone from the top. For example, determining whether bribery risks and the anti-bribery programme are on the agendas of board meetings; the extent of involvement of those at the very top of the organisation in anti-bribery training and communications, and actions taken by senior management when integrity and bribery issues are identified.

This stage commences with a request for detailed information from the management of the target, to be considered by the purchaser.

The stage concludes with preparation of an anti-bribery due diligence report for the deal or portfolio management team to consider alongside other due diligence (e.g., legal and financial etc). The report would be produced by the support functions, who might typically include the legal counsel, finance department, compliance officer, internal anti-corruption experts, and any other relevant functions such as corporate affairs, as well as external advisers.

As in stage 2, if risks are identified, the purchaser will explore how such risks could be mitigated. Certain risks, such as historical bribery, may require discussion with the authorities. If the risks cannot be mitigated and it is concluded that they are unacceptable the proposal may be dropped at this stage.

A thorough review will typically cover the activities listed below:

- *Detailed review of the target's markets and competitors' activities* to help form an assessment of whether bribery is a known or likely factor.
- *Corporate intelligence and background checks* undertaken on the target's business and key owners/directors and management.
- *The target's anti-bribery programme* examined in detail to assess its adequacy and any risks of bribery.
- *Assessing the tone from the top of the target company*, for example through using interviews with senior managers and directors to discuss the target's anti bribery programme, issues and risks.
- *Interviewing management representatives in key functions that represent bribery risks* (such as sales directors in certain markets). This will also involve assessing their openness to post-acquisition improvement in the target's anti-bribery programme as part of the integration process.
- *External interviews and site visits*. In addition to internal sources within the target, external sources will be interviewed including obtaining informal comments from actors within the relevant sectors and countries, such as customers, suppliers, industry experts, regulatory authorities, business associations, embassy officials, NGOs.
- *Walk-through tests*, carried out to confirm that policies and procedures are effectively implemented.
- *Review of data* provided by the target company – this will usually be located in a data room.
- *Detailed financial review* is a key aspect of the due diligence, and is outlined in the box below.

Due diligence financial review

A key part of the anti bribery due diligence is to address the veracity of financial transactions and it would be expected to cover the following:

- Understand the financial processes of the target In order to identify the data to be requested and be able to know that data provided is complete – the review team must be able to understand and navigate through the target's financial systems, as well as being able to understand the target's technology platform.
- Check that the financial system and finance function have appropriate controls, e.g., segregation of duties.
- Carry out extraction, and reconciliation, of accounting data together with careful analysis of the supporting documentation.
- Review of financial transactions should start with the audited accounts where these are available and a detailed listing of transactions that formed those accounts (together these are termed the 'ledger') – it will be important to ensure these accounts are reconciled for the review team to be assured that it has been given the correct information.
- Detailed scrutiny of books and records including electronic data and analysis of accounts in sufficient detail to be able to examine line entries which could be problematic, for example:
 - Expense transactions are recorded in a way that enables the substance of the transaction to be identified, including nature of product or service, price, provider and beneficiary of payments;
 - Sales transactions are recorded in such a way that the substance of the transaction can be identified, including the goods or services sold, the customer, the payor and the price;
 - Underlying records are available for inspection and able to be linked to specific transactions.
- The target should be expected to provide all supporting documentation to transactions including, where relevant, emails.
- Use of forensic software can help in identifying transactions for close scrutiny.
- Analytical tests on data and then examination of samples (this includes a review of supporting documentation) of:
 - a. High risk payments to distributors, subcontractors, and/or consultants.
 - b. High risk transactions paid for using cash.
 - c. Payments for high risk expense types (includes visas, customs, taxes, government certificates, licences, bonuses, commissions, gifts, entertainment, travel, donations, marketing).
 - d. Employee expense reports for high risk transactions.
 - e. High risk revenue side transactions including price setting, discounts, credit notes and free of charge goods.

SIGNPOST

When carrying out financial analysis, the review team should first understand the financial processes of the target in order to identify the data to be requested and to then know that the data provided is complete.

STAGE 4: DECISION

The portfolio management or M&A team will prepare a proposal for the purchase or investment for review by the acquisition committee or equivalent body. The proposal will include a review of the due diligence findings related to bribery, any identified issues and how these could be mitigated, including discussions with the relevant authorities. Where the bribery risk is judged to be high, the purchaser must decide whether or not it should withdraw from the planned investment.

However, even when the bribery risk is considered high, there is an option to proceed and this might typically involve:

- Discussing with the management of the target how its anti-bribery programme could be brought to the required adequate level, risks remediated, contracts potentially renegotiated and re-tendered, and how any corrupt employees and associates would be removed from the target;
- Discussing the bribery concerns with the relevant legal authorities with a view to obtaining an opinion on whether proposed remedial actions would be satisfactory and that the purchaser would not be liable to criminal charges and sanctions.

If satisfactory assurances are obtained, the investment committee or executive review body can make its decision and the proposal will then proceed to the partners or board for approval.

SIGNPOST

In the UK, the SFO has advised that it encourages purchasers which discover problems in the course of M&A due diligence to talk to the SFO about what they propose to do if the acquisition goes ahead. The SFO states that it wants to be in a position to give assurance about the approach of the SFO if the company does carry out the programme of work for anti-bribery.

STAGE 5: POST-ACQUISITION DUE DILIGENCE

Due diligence continues after the investment is completed and will be critical and urgent if access to information has been restricted or denied in the pre-purchase phases as may often be the case.

If insufficient information was obtained to undertake a satisfactory due diligence pre-closure, this should be initiated as soon as the transaction completes. In such circumstances, the stages of due diligence outlined above should be taken post-completion with a clearly-defined timetable.

Due diligence continues after the investment is completed and will be critical and urgent if access to information has been restricted or denied in the pre-purchase phases as may often be the case

Remedial action will be needed if bribery risks are identified and it will be necessary to report suspected bribery promptly to the authorities. If the purchaser identifies any bribery issues quickly after acquisition and commits to full cooperation with the authorities, this could assist in reaching a settlement.

SIGNPOST

Companies can be especially vulnerable to side-lining anti-bribery issues in the post-acquisition integration. With many other issues to consider and the handover from a deal team to an integration team, anti-bribery due diligence and integration can easily be neglected. However, good practice is for it to form part of a post-completion phase such as a ninety-day plan.

STAGE 6: POST-ACQUISITION INTEGRATION AND MONITORING

At the same time as post-acquisition due diligence is being carried out, integration starts to bring the acquired company in line with the purchaser's anti-bribery programme. The post-acquisition due diligence will contribute to this by establishing any inadequacies in the acquired company's anti-bribery programme.

Depending on the size and nature of the purchased business, the post-acquisition due diligence and integration process can take a considerable time, possibly up to twenty-four months, as the revised anti-bribery programme will have to be amended or designed and then rolled out across the business operations of the acquired company.

When the integration process is complete, the acquired company or investment should be monitored as part of the purchaser's anti-bribery programme.

4. CHECKLIST

This section provides a checklist of indicators as an aid to due diligence (referred to in the checklist as DD). The checklist is a general guide; it cannot be comprehensive as the scope and depth of due diligence will be determined by the purchaser's risk approach and the particular circumstances and risks of the target. Each M&A and acquisition will present unique circumstances.

It is stressed that the checklist should not be used as a 'tick-box approach' for due diligence but as an aid to prompt thinking about the areas to be considered during due diligence. Due diligence often involves subjective decisions based on qualitative information. Being able to tick every box will not in itself demonstrate that the due diligence is comprehensive in scope or carried out adequately. The purchaser should use this guidance as a starting point and through experience build on this and tailor it as a tool for use in due diligence on acquisitions and investments.

Bribery due diligence process		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
1	Is the bribery DD integrated into the DD process from the start?				
2	Have milestones been set for the bribery DD?				
3	Is the timetable adequate for effective anti-bribery DD?				
4	Have the deal and DD teams been trained in their company's anti-bribery programme including the significance of relevant legislation?				
5	Have the deal and DD teams been trained in anti-bribery DD?				
6	Is there a process implemented for co-ordination across functions?				
7	Has legal privilege been established with use of general counsel and external legal advisers?				
8	Is there a process for dealing with any bribery discovered during the DD?				
9	Is the person responsible for anti-bribery due diligence at a sufficiently senior level to influence the transaction's decision-makers?				

Inherent risks: geographical and sector

A target such as an extractives company operating in countries where corruption is prevalent will present higher risks than one operating only in developed countries in lower risk sectors. Some sectors such as construction and engineering, defence and healthcare, are known to have higher risks than others. However, companies that operate in difficult countries or sectors are more likely to have developed advanced anti-bribery programmes to mitigate the higher risks.

There are a number of resources that can be referred to in mapping geographical and sector risks. Transparency International provides surveys of aspects of corruption, notably the Corruption Perceptions Index which can be consulted for evaluation of corruption risks in the countries and business sectors in which the company is doing business.⁵ A risk map can be useful in developing a picture of the target organisation's vulnerability – this will score countries, sectors and other risk areas.

5. Surveys and risk-mapping resources include the Corruption Perceptions Index; the Bribe Payers Index; the Global Corruption Barometer; and National Integrity Studies. These can be downloaded from www.transparency.org

Geographical and sector risks		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
10	Is the target dependent on operations in countries where corruption is prevalent?				
11	Does the target operate in sectors known to be prone to high risk of bribery?				
12	Are competitors suspected to be actively using bribery in the target's markets?				

Business model risks

The organisational structure of the target and its business model should be reviewed as these may present inherent risks of bribery.

The target may be heavily decentralised, creating the risk of inconsistency in carrying through an anti-bribery programme across its operations. It may allow subsidiaries to adopt anti-bribery programmes to varying standards of practice.

There can be risks where the target is dependent on the award of large public or private sector contracts such as construction or critical licenses such as in telecommunications or the health sectors. It should be noted that bribery scandals have also occurred related to large public contracts in developed countries. If a market includes competitors that are actively bribing to win contracts this will be a risk both from the pressure on employees and intermediaries to make bribes and the imbalance it creates in the sector when contracts are not won on merit. The risks on large contracts or obtaining of licenses will also depend on the use agents and other intermediaries which are common areas of risk.

Where critical functions such as property, facilities, purchasing and contracts and accounting are outsourced, it will require greater attention to ensure the anti-bribery programme is embedded in their activities.

Business model risks		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
13	Does the organisational structure of the target foster an effective anti-bribery programme or present risks?				
14	Is the target dependent on large contracts or critical licenses?				
15	Does the target implement an adequate anti-bribery programme in its subsidiaries?				
16	Is the target reliant on agents or other intermediaries?				
17	Has the target been assessed for its exposure to use of intermediaries that operate in countries and sectors prone to corruption risks?				
18	Does it have policies and effective systems to counter risks related to intermediaries?				
19	Does the target require contractual anti-bribery standards of its suppliers?				
20	Does the target's organisational structure present bribery risks – e.g. diversified structure?				
21	Is the target reliant on outsourcing and if so do the contracted outsourcers show evidence of commitment and effective implementation of the target's anti-bribery programme?				

Legislative footprint

While the UK Bribery Act and FCPA are important pieces of legislation, and are referred to in this guidance and the Annex, the purchaser should ensure that the target meets all relevant regulatory requirements in order to provide appropriate protection.

Legislative footprint		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
22	Is the target subject to the UK Bribery Act and/or the US FCPA?				
23	Are there equivalent laws from other jurisdictions that are relevant?				

Organisational

The purchaser should look for evidence that the target has an anti-bribery culture that is fully integrated into the corporate culture. This can be deduced, for example, by examining the commitment of the target's board and top management to integrity, both in embedding integrity in the target and to their personal integrity, measures of communication and training of employees and results of surveys of employee and supplier attitudes. There should be research to determine if there are any corruption allegations or incidents related to main shareholders and investors, directors and senior management of the target. Activism by shareholders and investors in requiring a culture of anti-corruption in the target will be a positive factor. There may be structural characteristics of the organisation that foster anti-corruption or conversely, present risk that the anti-bribery programme is poorly communicated and overseen.

Organisational		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
24	Does the target's board and leadership show commitment to embedding anti-bribery in their company?				
25	Does the target exhibit a culture of commitment to ethical business conduct? (Use evidence such as results of employee surveys)				
26	Has the senior management of the target carried out an assessment of bribery risk in the business?				
27	Have there been any corruption allegations or convictions related to members of the target's board or management?				
28	Have the main shareholders or investors in the target had a history of activism related to the integrity of the target?				
29	Have there been any corruption allegations or convictions related to the main shareholders or investors in the target?				
30	Does the target have an active audit committee that oversees anti-corruption effectively?				

6. Guidance to the UK Bribery Act 2010 and good practice for corporate anti-bribery programmes – available from <http://www.transparency.org.uk/working-with-companies/adequate-procedures>

7. The terminology 'Foreign Public Official' or FPO is commonly used, although bribery of domestic officials is also illegal in most jurisdictions

Anti-bribery Programme

The due diligence must establish the adequacy of the target's anti-bribery programme. Any deficiencies will present risks. External anti-bribery advisers can be used to assess the adequacy of the programme.

Anti-bribery Programme		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
31	Does the target have an anti-bribery programme that matches that recommended by Transparency International UK? ⁶				
32	Is the anti-bribery programme based on an adequate risk-based approach?				
33	Is the anti-bribery programme implemented and effective?				

Key bribery risks

There are high risk areas that should be singled out for review and these are listed below.

Key bribery risks		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
34	Has the target been assessed for its exposure to risk of paying large bribes in public contracts or to kickbacks?				
35	Has the target been assessed for risks attached to hospitality and gifts?				
36	Has the target been assessed for risks attached to travel expenses?				
37	Has the target been assessed for risks attached to political contributions?				
38	Has the target been assessed for risks attached to charitable donations and sponsorships?				
39	Has the target been assessed for risks attached to facilitation payments?				

(Foreign) public officials (FPOs) ⁷		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
40	Is there an implemented policy and process for identifying and managing situations where FPOs are associated with intermediaries, customers and prospects?				
41	Have any FPOs been identified that are associated with intermediaries, customers and prospects?				
42	Is there an implemented policy and process for identifying and managing situations where FPOs are associated with intermediaries, customers and prospects?				
43	Have any FPOs been identified that present particular risk?				
44	Is there evidence or suspicion that subsidiaries or intermediaries are being used to disguise or channel corrupt payments to FPOs or others?				

Financial and ledger analysis⁸		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
45	Have the financial tests listed on page 11 been carried out?				
46	Are the beneficiaries of banking payments clearly identifiable?				
47	Is there evidence of payments being made to intermediaries in countries different to where the intermediary is located and if so are the payments valid?				
48	Is there evidence of regular orders being placed in batches just below the approval level?				
49	Are payments rounded, especially in currencies with large denominations?				
50	Are suppliers appointed for valid reasons?				
51	Is there evidence of suppliers created for bribery e.g. just appointed for the transaction, no VAT registration?				
52	Is there evidence of special purpose vehicles created to act as channels for bribery?				

Incidents

The history of any incidents of bribery related to the target needs to be known. This information will be obtained from a schedule provided by the target and reviewed by forensic advisers.

Incidents		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
53	Has a schedule and description been provided of pending or threatened government, regulatory or administrative proceedings, inquiries or investigations or litigation related to bribery and other corruption?				
54	Has the target provided a schedule of any internal investigations over the past five years into bribery allegations?				
55	Has the target been involved in any bribery incidents or investigations not reported by the target?				
56	Has the target sanctioned any employees or directors in the past five years for violations related to bribery?				
57	Has the target sanctioned any business partners in the past five years for violations related to bribery?				
58	Is there an implemented policy and process for reporting bribery when discovered during due diligence?				

Audit reports		Reviewed	Yet to be completed	Comment reference no.	Evidence reference no.
59	Has the target provided any reviews, reports or audits, internal and external, carried out on the implementation of its anti-bribery programme?				

⁸ In certain transactions, for example with a high-risk target where there is a strong likelihood of bribery, the financial and ledger analysis will be a particularly important part of the process. In such cases, a deep-dive ledger analysis would comprise a fuller range of indicators than is listed here

ANNEX I: THE LEGAL CONTEXT

A.1 INTRODUCTION

This section aims to assist purchasers and investors in understanding the implications for transactional due diligence of the legal context, including the UK Bribery Act 2010 ('the Bribery Act') and the US Foreign Corrupt Practices Act (FCPA). It compares the provisions of the Bribery Act with enforcement theories already established in this area under the FCPA. Although the focus of this section is the Bribery Act and the FCPA, each jurisdiction will have its own variants of the legal environment and enforcement scenarios outlined in this section.

While it is likely that much anti-bribery due diligence will be driven by legal obligations, it is important to recognise that taking a good practice approach will be the best way to avoid both legal liabilities and the potential financial and reputational damage that may come from investing in or purchasing a company associated with bribery.

A.2 UK BRIBERY ACT

For the first time, the proper conduct of transactional due diligence will be considered necessary as part of a company's response to UK anti-bribery law. The mergers and acquisitions process now requires adequate due diligence in order to avoid Bribery Act liability. The legal requirements for due diligence for minority investors under the Bribery Act are less clear although there is greater clarity over their liabilities under the FCPA.

A.2.1 Current corruption by the target company

The Bribery Act creates four new offences of bribery. Paying a bribe, receiving a bribe and bribing a foreign public official are the 'principal' offences. The fourth offence is of failure by a commercial organisation to prevent bribery (the 'failure to prevent bribery offence').

It is too soon to know how the Bribery Act will be interpreted and enforced. However a preliminary analysis of the Bribery Act suggests that there is likely to be liability related to failures in due diligence for the purchaser when there is current or continuing bribery by an acquired company⁹. Enforcement action could be based upon the following scenarios:

- a) Pre-closing due diligence is performed and current or continuing bribery is not identified and the diligence was inadequate. Following completion of the transaction the bribery continues and is undertaken by an associated person, e.g., an employee of the acquired company.
- b) Bribery risks are identified in pre-closing due diligence but there is a failure to follow up adequately the risks identified during integration and/or through normal post-closing procedures. Bribery, that should have been uncovered through a proper follow up of the risks revealed in the due diligence, continues, and is undertaken by an associated person, e.g., an employee of the acquired company.

While it is likely that much anti-bribery due diligence will be driven by legal obligations, it is important to recognise that taking a good practice approach will be the best way to avoid both legal liabilities and the potential financial and reputational damage

⁹ Ministry of Justice Guidance issued on 30 March 2011 (MoJ Guidance) para 42

A.2.2 Liability for a principal offence in a transaction

As a generality, liability for a principal offence arises where the purchaser knowingly joins with, encourages or turns a blind eye to (by way of consent or connivance) the bribery activities of the target and its employees or associated persons.

The purchaser will commit a principal bribery offence in cases where the diligence process has revealed bribery by the target and where the purchaser continues with the bribery or allows it to continue post-acquisition.

Equally, if the purchasing company knows of continuing bribery and deliberately fails to conduct diligence so that the deal completes, this conduct could be viewed as criminal intent to participate in continuing corruption.

A.2.3 Liability for the failure to prevent a bribery offence

A failure by a purchaser to discover continuing corruption will not make a person or company liable for a principal bribery offence. However, if the undiscovered bribery continues post-acquisition, and is subsequently discovered, the company may be guilty of the 'failure to prevent' offence.

This liability might be reinforced if poor anti-bribery due diligence was carried out. The Bribery Act provides a defence if an entity can demonstrate that it had established 'adequate procedures' to prevent bribery by associated persons, and it is likely that effective anti-bribery due diligence during M&A transactions would be viewed as an 'adequate procedure'.

Indeed, the Ministry of Justice (MoJ) Guidance references the requirement to carry out thorough due diligence in the mergers and acquisitions context¹⁰, although little specific attention has been given to the basis of criminal liability in this context either in the MoJ Guidance or in authoritative public statements from the SFO.

A.2.4 Historic bribery by the target company

Concluded or 'historic' conduct, regardless of whether undiscovered or not revealed in the due diligence process, probably would not create liability in respect of the principal offences of the Bribery Act or the 'failure to prevent' offence.

This appears to be the case principally because it is only from the date of closing that the target becomes factually 'associated' with the purchaser. At the time the offences were committed by the target, it was not associated with the purchaser.

Further the purpose of the conduct would, in all likelihood, have been for the benefit of the target, not for the purchaser. Consequently it seems unlikely that the SFO would be able to bring an enforcement action for failure to prevent bribery based on the historic and concluded conduct of the target. However, the individuals involved in the bribery would be still liable to prosecution, which might well impact on the purchaser.

Moreover, where the purchaser benefits from historic corruption or purchases an asset tainted by corruption, it may have liability under the Proceeds of Crime Act 2002 (POCA). Historic bribery is likely to create an inherited liability for the purchaser under the FCPA in the US.

¹⁰. MoJ Guidance para 4.4

A.2.5 Bribery may trigger liability under other UK laws

Bribery can also be investigated and prosecuted under a variety of UK laws. Bribery investigations sometimes begin as money laundering allegations, and penalties can be secured under laws other than those specific to bribery offences such as the POCA in the UK.

For example, where a merger or acquisition results in the purchase of a target that either historically or currently is involved in bribery or, where a merger or acquisition is primarily the acquisition of an asset which itself has been obtained by bribery or other illegality, there is likely to be a benefit to the acquiring company. Going forward, there is also likely to be a revenue stream from the target or asset that accrues to the purchaser. In short the purchaser may acquire 'criminal property' and risk committing a money laundering offence under POCA, which can bring associated reporting obligations.

Cases have also been brought in relation to 'books and records offences' which, in the UK, are essentially charges brought under the Company's Act 1985 for failure to keep adequate accounting records.

A.3 US LAW AND ENFORCEMENT

The US Department of Justice (DOJ) has penalised companies for their failure to conduct transactional due diligence adequately in numerous enforcement actions and settlements under the FCPA. These enforcement actions and settlements provide a basis for understanding when the DOJ will bring an enforcement action and the legal basis for it. Additionally the DOJ has also provided guidance to companies through its Opinion Release Procedure, most notably in relation to Halliburton's proposed purchase of a UK-based company.¹¹

The FCPA prohibits payments to foreign officials, foreign political parties or officials, or candidates for foreign political office in order to obtain, retain, or direct business.¹² The FCPA also requires issuers to maintain accurate books and records and a system of internal accounting controls. In the case of foreign corporations, the FCPA applies to issuers, or foreign companies that register securities on a U.S. securities exchange. If a foreign corporation is not an issuer, there must be some other connection to the US for jurisdiction to be implicated.

FCPA due diligence is now a standard component of a merger or acquisition, in part because the DOJ has taken a number of enforcement actions based on due diligence failures pre- or post-closing and/or the purchasers' failures to monitor compliance properly in the post-closing integration phase.

A.3.1 FCPA enforcement and successor liability

Enforcement actions have been based on two prosecutorial theories:

- First, that undiscovered pre-acquisition bribery conduct is inherited by the successor entity;
- Secondly, the purchaser also accrues failures subsequently to address bribery risks that are identified in the diligence process post-dating the closure of the transaction.

FCPA due diligence is now a standard component of a merger or acquisition, in part because the DOJ has taken a number of enforcement actions based on due diligence failures

11. Opinion Release 08-02. See 15 U.S.C.A. §§ 78dd-1(a); 78dd-2(a); 78dd-3(a)

12. See 15 U.S.C. § 78m(b)

US regulators approach successor liability under the FCPA for pre-transaction conduct by seeking to impose liability for knowingly purchasing or investing in circumstances where there is corrupt activity by the counterparty.¹³

In 2009, the DOJ secured a conviction against investor Frederick Bourke in a related criminal trial for conspiring to violate the FCPA in relation to an \$8 million investment by Bourke in a consortium which was seeking to invest in the privatisation of the State Oil Company of the Azerbaijan Republic (SOCAR).

The DOJ successfully pursued the theory that Bourke had actual knowledge, or should have known – and was wilfully blind in not knowing – that the investment consortium provided improper gifts and payments to Azeri government officials in order to increase the likelihood that the privatisation would occur.

At trial, the DOJ focused on Bourke's failure to conduct due diligence, failure to engage an experienced law firm to conduct any such due diligence on his behalf and that he ignored 'red flags' that would have alerted him to the corrupt nature of the investment.¹⁴ The case continues on appeal and the eventual outcome is far from certain. However, it illustrates a potential approach the DOJ may take towards investors.

A.3.2 The role of anti-bribery due diligence in reducing FCPA-related risk

In a series of Opinion Procedure Releases, the DOJ has suggested that companies can minimise liability or insulate themselves from liability for unlawful payments made by foreign entities they are seeking to acquire by performing adequate due diligence prior to acquisition, disclosing any pre-acquisition misconduct to the government, and implementing effective compliance procedures to avoid further unlawful activity by the acquired entities.¹⁵

The DOJ and the Securities & Exchange Commission (SEC) generally take the position that 'red flags' identified during the due diligence must be fully investigated to determine whether a corrupt payment in fact occurred.

The unstated premise of these Opinion Procedure Releases is that a company that does not engage in adequate diligence and promptly disclose pre-acquisition misconduct by the entity that is to be acquired might face enforcement action for FCPA violations that occurred before the close of the transaction.

A.3.3 FCPA and liability for historical bribery

The DOJ and the SEC have taken the position that liability can attach for pre-acquisition conduct and have brought enforcement actions consistent with this approach. It is worth noting, however, that in these cases it seemed the illicit payments by the target continued past the closing date of

13. U.S. Announces Settlement with Hedge Fund Omega Advisors, Inc. in Connection with Omega's Investment in Privatization Program in Azerbaijan, Dep't of Justice Press Release No. 07-172, July 6, 2007, <http://www.justice.gov/criminal/fraud/fcpa/cases/docs/07-06-07omega-settlement.pdf>

14. Connecticut Investor Found Guilty in Massive Scheme to Bribe Senior Government Officials in the Republic of Azerbaijan, Dep't of Justice Press Release No. 09-667, July 9, 2009, <http://www.justice.gov/criminal/fraud/fcpa/cases/docs/07-10-09bourke-verdict-sdny.pdf>

15. U.S.C.A. §§ 78dd-1(a); 78dd-2(a); 78dd-3(a)

The DOJ and the SEC have taken the position that liability can attach for pre-acquisition conduct and have brought enforcement actions consistent with this approach

the transaction, and the government sought to charge the parent company for all the pre- and post-acquisition misconduct collectively. Whether the DOJ would bring an enforcement action for solely pre-acquisition conduct, and whether a court would uphold such a prosecution if challenged, are both open questions.

However, as the DOJ's recent Opinion Procedure Releases make clear, if a company undertakes sufficient due diligence in advance of the transaction and discloses any unlawful payments uncovered as a part of that investigation, it may be able to protect itself from prosecution. With respect to liability for unlawful activity occurring post-transaction, the DOJ has made clear that 'an acquiring company may be held liable as a matter of law for any unlawful payments made by an acquired company or its personnel after the date of acquisition.'¹⁶

Indeed, in recent years both the DOJ and the SEC have brought enforcement actions under the FCPA against parent companies for unlawful payments made by their newly-acquired subsidiaries, even though the bribes were made only shortly after the acquisition was completed. When charging violations of the FCPA under these circumstances, the DOJ and SEC have highlighted the failure of the acquiring company to perform adequate due diligence in advance of the transaction in order to uncover corrupt payments, or the failure of the company to take corrective action when diligence suggests the possibility that unlawful payments have been made in the past.¹⁷

A.4 ADDITIONAL CONSIDERATIONS FOR PRIVATE EQUITY INVESTMENT

There may be additional legal concerns for private equity companies in relation to the Bribery Act, over and above those encountered in M&A activity. For example, where senior officers of a private equity company participate or consent to or connive with the investment target or portfolio company there is potential liability for a principal bribery offence. Under the FCPA, the DOJ may develop an enforcement action based upon a knowing or reckless failure to diligence – whether it be in the majority or minority investment context.

Under the Bribery Act, one area of uncertainty is whether a private equity firm or a passive investor can be liable for their failure to conduct effective diligence over the actions of the target or portfolio company either during the investment or, in the case of private equity, during the management phase. Irrespective of this, it is good practice for private equity companies to undertake effective anti-bribery due diligence.

Often, but not always, the investment target or portfolio company does not perform services 'for or on behalf' of the investor or private equity firm and consequently they cannot be associates. However it is likely that the SFO will want to investigate where they consider the relationship is one where there is sufficient control over the associate and sufficient benefit to the investor or private equity firm. It is likely that the SFO will seek to penetrate corporate structures designed to frustrate the purposes of the legislation. Importantly in that respect, the Bribery Act defines an associate broadly, 'irrespective of capacity' and by reference to 'all the circumstances and not merely by reference to the nature of the relationship between the associated person and the commercial organisation.'¹⁸

Consequently, where the investor or the private equity firm in fact exercises strong control over

16. DOJ Opinion Procedure Release No. 08-02 (June 13, 2008)

17. See, e.g., SEC Brings Settled Charges Against Tyco International Ltd. Alleging Billion Dollar Accounting Fraud, SEC Litigation Release No. 19657, Accounting & Auditing Enforcement Release No. 2414 (Apr. 17, 2006), <http://www.sec.gov/litigation/litrelases/2006/lr19657.htm>

18. Section 8(3)

the portfolio company – it is possible that the SFO might develop enforcement actions. These could be based upon their being 'associates' for the purposes of the Bribery Act if the portfolio company bribes another person for the benefit or business advantage of the investor or private equity firm.

Furthermore, the recent use in the Mabey & Johnson case by the SFO of the Proceeds of Crime Act 2002 (POCA) to confiscate from a parent/holding company the dividends relating to corrupt transactions creates an additional precedent that is highly relevant to private equity investors.¹⁹

A.5 DUE DILIGENCE OBLIGATIONS FOR MINORITY INVESTMENTS

While the Bribery Act and FCPA create a clear legal rationale to perform due diligence in an acquisition or where the purchaser takes a majority or controlling investment, the point at which a minority investment become too small to warrant full due diligence remains an open question. Likewise, the legal risk to a minority investor or private equity firm in a non-controlling investment relationship is unclear. There is not an exact correlation between size of stake and the possible legal risks. In some cases, even taking a small stake in a corrupt company where the investor knew or where it could be inferred that it knew that the company was engaged in bribery could lead to a legal liability whether under the Bribery Act or when the private equity firm suspects bribery and fails to report its suspicion under POCA.

The investor must therefore judge the level of due diligence taking into account various factors. These will include the value of the investment, the percentage of ownership, the degree of influence over the target, the risks attached to the target such as markets and sectors, the reputational risk, the legal risk and the risk appetite. Each situation will depend on its own precise circumstances.

In the UK, there has to date been limited regulatory guidance on these questions. However, in response to questions over private equity, the Director of the SFO has stated:

"[One] issue ... is your responsibility if any of the companies that you own pays bribes. You might at first think that this is nothing to do with you as the owners of the company. It might be that as portfolio owners you are not committing an offence of failing to prevent bribery. But it does not end there... we will be looking at money laundering in order to see what money has been laundered as a result of the criminal conduct and to whom it has gone. It may be indeed that the owners have some knowledge of the contract that was obtained through bribery. We will be thinking about money laundering."²⁰

A.6 REPORTING OBLIGATIONS

The presumption of this guidance is that, as good practice, any incidence of bribery discovered during due diligence should be reported to the appropriate authorities. Purchasers may use their discretion, bearing in mind factors such as proportionality in reporting, the deal timetable and their own legal obligations, but it is in their interest to report to authorities as in this way they can discuss the issue and establish how the bribery could affect the deal.

Reporting obligations vary by jurisdiction. In the UK, for example, reporting is mandatory in the

19. <http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2012/shareholder-agrees-civil-recovery-by-sfo-in-mabey--johnson.aspx>

20. Speech of 21 June 2011

money laundering context but discretionary when corruption is discovered. It is legally required in many jurisdictions, and professional advisors are often subject to separate regulations that may require them to report criminal behaviour. In the UK, for example, when a corrupt scheme is discovered, there may be a legal obligation to make a Suspicious Activity Report (SAR) to SOCA, and corruption-based SARs are automatically flagged to the SFO. There are enhanced requirements under POCA for firms involved in the regulated sector.

If a purchaser or investor subject to the FCPA discovers bribery or bribery indicators in a target, there are advantages in reporting the issues raised by due diligence to the DOJ and this may be done jointly with the target. At this point the purchaser or investor may decide not to proceed with the transaction but it could wait to see if the target can reach a settlement with the DOJ to clear the way for the M&A or investment to go ahead with no risk of successor liability.

In the UK, the SFO has stated that it is sympathetic to situations where a purchaser or investor reports that it has discovered corruption as part of due diligence²¹ and that, in certain circumstances, it will take no action if the purchaser is committed to anti-bribery remedial actions.

It is unclear whether that stance is dependent upon the purchaser disclosing the corruption prior to closing. The Director of the SFO has stated with regard to private equity investments:

"What we encourage companies to do in those circumstances is to come to us as soon as they can after the acquisition in order to talk to us about the issues that they are finding...We would therefore be sympathetic if a company came to us and said that it had recently taken over another company and that there were a number of issues concerning corruption that had been identified. In those circumstances I can see little benefit in an SFO investigation at the corporate level...I would want the company to tell us about what it has found and about how it is proposing to deal with this. I would want to be satisfied that this is a genuine commitment and I would like to be kept informed from time to time about progress. In these circumstances I would want to let the company get on and do whatever was needed in these circumstances."²²

It should also be noted that the SFO has sent out clear signals that senior individuals who decide not to report on-going bribery are potentially taking on personal liability. In a speech of November 2011 the Director of the SFO stated:

"The last feature of the Bribery Act that I want to draw attention to concerns the liability of senior officers of a corporation. There is a new offence that is committed by a senior officer with a UK connection who consents to or connives in bribery. You may be or you may know people who are senior officers such as Executive or Non Executive Directors of UK or foreign corporations and who have a UK connection. If you or they know about bribery and decide to do nothing about it, then you or they have connived in bribery. An offence under the Bribery Act has been committed. I tell Executives to be very careful not to turn a corporate criminal issue into a personal criminal issue. It is avoidable."

Senior individuals who decide not to report on-going bribery are potentially taking on personal liability

21. Approach of the Serious Fraud Office to dealing with Overseas Corruption (2009) paragraphs 17-20

22. Speech of June 21 2011 - see <http://www.SFO.gov.uk/about-us/our-views/director's-speeches/speeches-2011/private-equity-and-the-uk-bribery-act,-hosted-by-debevoise--plimpton-llp.aspx>

ANNEX II: DEFINITIONS

Agent: a representative who normally has authority to make commitments on behalf of the principal represented. The term 'representative' is being used more frequently since agent can imply more than intended and in some countries 'agent' implies power of attorney.

AML: anti-money laundering.

Anti-bribery programme:²³ the whole of a company's anti-bribery efforts including values, code of conduct, detailed policies and procedures, risk management, internal and external communication, training and guidance, internal controls, oversight, monitoring and assurance.

Business Principles for Countering Bribery: a good practice model for corporate anti-bribery policies and programmes developed through a multi-stakeholder process initiated and led by Transparency International.

Closing: the final event to complete the investment, at which time all the legal documents are signed and the funds are transferred.

Data room: physical rooms or online virtual sites used to store confidential data for disclosure to potential purchasers for the due diligence process.

Department of Justice (DOJ), USA: the central agency for enforcement of US federal laws.

Due diligence: also termed transactional due diligence, the process of investigation and evaluation of a business before making an investment or acquiring a company – in the case of anti-bribery this will be to assess any successor liability risks for past or current bribery, the adequateness of the target's anti-bribery programme and the inherent risks of bribery related to the target including its market sectors and the countries in which it operates.

Foreign Corrupt Practices Act 1977 (FCPA): a United States federal law (15 U.S.C. §§ 78dd-1, et seq.) generally prohibiting US companies and citizens and foreign companies listed on a US stock exchange from bribing foreign public officials to obtain or retain business. The FCPA also requires 'issuers' (any company including foreign companies) with securities traded on a US exchange to file periodic reports with the Securities and Exchange Commission to keep books and records that accurately reflect business transactions and to maintain effective internal controls.

Foreign Public Official (FPO): as defined in the Bribery Act, an individual who holds a legislative, administrative or judicial position of any kind, exercises a public function for or on behalf of a country or territory outside the UK or for any public agency or public company of that country or territory, or is an official or agent of a public international organisation. Unlike the FCPA, under the Bribery Act the term FPO does not include foreign political parties or candidates for foreign political office.

General partner: a partner who takes part in the daily operations of the partnership and is personally responsible for the liabilities of the partnership – see also, limited partner.

23. *Business Principles for Countering Bribery, 2009 edition, page 6*

Limited partner: a partner in a partnership who in the case of a private equity firm provides investment funds and has a share of ownership but takes no part in managing the partnership. A limited partner (LP) is not liable for any amount greater than the original investment in the partnership. The general partners pay the LPs a return on their investment that will be defined in a partnership agreement – see also, general partner.

Ministry of Justice, UK (MoJ): the UK government ministry responsible for the Bribery Act and its accompanying Guidance.

Politically Exposed Person (PEP): a person who has been entrusted with a prominent public function, is a senior political, or is closely related to such persons. By virtue of a public position and the influence it holds, and the provisions of anti-bribery acts related to FPOs, a PEP may present a higher risk related to bribery.

Portfolio company: a company in which a private equity firm invests – the portfolio comprises all the companies in which the firm invests.

Private equity firm²⁴: a firm authorised that is managing or advising funds that either own or control one or more companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies.

Purchaser: the investing entity – this could be a company making an acquisition or a merger, or a private equity firm carrying out a portfolio investment.

Securities and Exchange Commission (SEC): the SEC is an independent United States agency which holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets in the United States.

Serious Fraud Office (SFO): the SFO is an independent UK Government department which investigates and prosecutes serious or complex fraud, and corruption. It is part of the UK criminal justice system with jurisdiction in England, Wales and Northern Ireland but not in Scotland, the Isle of Man or the Channel Islands.

SOCA: Serious & Organised Crime Agency, UK

Target: the entity being considered for investment or acquisition.

²⁴. Definition based on that given in the 2007 Walker Report



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