Tuesday, October 20
2:30 pm–4:00 pm

407 - Strategic Alliances: Opportunities and Issues in the Current Economic Climate

Jason Meyer
Acting Assistant General Counsel
Heartland Payment Systems, Inc.

Ray Chappell Phillips
Associate General Counsel
Kimball International

Gregory Swinehart
Partner
Deloitte Financial Advisory Services LLP

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Faculty Biographies

Jason Meyer

Jason Meyer is a corporate counsel and compliance leader, currently in transition. He is also currently acting assistant general counsel for Heartland Payment Systems, Inc., in Princeton, NJ.

Mr. Meyer has experience heading business units and as a general counsel. Mr. Meyer was chief legal officer, corporate secretary, and senior vice president, ethics and corporate compliance for Kaplan EduNeering, a compliance solutions provider. Previously, Mr. Meyer was founder, president, and publisher of the LAWCAST® audio legal news services. Its publications included Intellectual Property LAWCAST, Corporate Counsel LAWCAST, Computer and Internet LAWCAST, and Employment and Labor LAWCAST. He served as general counsel for that company (which has since been sold), as well as for other media organizations. Mr. Meyer began his legal career as a litigator at Miami's Steel Hector & Davis, and then in New Jersey at Lowenstein Sandler, and Dechert.

Mr. Meyer is the chair of the ethics, governance, and compliance committee of the New Jersey Corporate Counsel Association (NJCCA). He also writes the blog LeadGood.org on ethics in business leadership, and is a featured columnist for the website CorporateComplianceInsights.com -- the first person ever selected for that role. In addition, he is a Cub Scout den leader.

Mr. Meyer earned his BA with high honors from Princeton University's Woodrow Wilson School and his law degree cum laude at the University of Pennsylvania.

Ray Chappell Phillips

R. Chappell Phillips is associate general counsel of Kimball International, Inc. in Jasper, Indiana. Mr. Phillips' main practice areas include U.S. and international commercial transactions, corporate, M&A, real estate, intellectual property, and regulatory compliance, as well as handling major project and litigation management. Mr. Phillips joined Kimball as associate corporate counsel and was later promoted to senior corporate counsel. Kimball International, Inc. provides a variety of products from its two business segments: the electronic manufacturing services segment and the furniture segment. The electronic manufacturing services segment provides engineering and manufacturing services, which utilize common production and support capabilities to a variety of industries globally. The furniture segment provides furniture for the office and hospitality industries, sold under the company's family of brand names.

Prior to joining Kimball, Mr. Phillips was associate director and general counsel of Crescent Capital Resources, LLC in Durham, North Carolina.

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Mr. Phillips is a member of ACC, ABA, and the Indiana State Bar Association.

Mr. Phillips received a BA from the University of North Carolina at Chapel Hill and his JD from the University of North Carolina School of Law in Chapel Hill.

Gregory Swinehart

Gregory Swinehart is the United States and North American managing partner of Deloitte's forensic and dispute services practice. In serving clients, Mr. Swinehart and his team frequently work with alliance partners. He provides specialized economic, operational, and accounting consulting services to clients.

Prior to joining Deloitte, he was a partner in a boutique consulting firm. Before getting his MBA and starting in the consulting world he was a product and process engineer at 3M. Prior to his current roles at Deloitte, he led practices in Minneapolis, New York, and Chicago. Mr. Swinehart has provided service to clients in a number of areas, including economic modeling, valuation, bankruptcy consulting, and business process improvement. He has extensive experience as an expert witness.

Mr. Swinehart has been quoted in a number of major publications, he has published professional articles including a paper related to valuation considerations in commercial alliances, and he has given numerous presentations to professional groups. He is a licensed certified public accountant (seven states), a chartered financial analyst, and a certified management accountant. Mr. Swinehart serves or has served on a number of boards of directors.

Mr. Swinehart has an undergraduate degree, an MBA from the University of Chicago, and he completed all requirements but his dissertation for a PhD from the University of Minnesota.

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Discussion Overview

- Three Phases of Any Alliance
  - Starting, Continuing, Ending
- Implications from each phase:
  - Drafting
  - Negotiating
  - Cost in a tight economy
- Summaries: Best practices in T's and C's

Strategic Alliances: What are they?

- Definition: A strategic alliance is a *formal*, *mutually-beneficial*, *long-term relationship* between two or more companies leveraging their respective *core competencies* to pursue a set of *agreed upon goals* while *remaining independent* organizations.

Strategic Alliances: How are they structured?

- Equity
  - Example: Established corporate partner invests in smaller, rapidly growing technology company.
- Non-equity
  - Example: Automotive Tier 1 supplier company enters into definitive supply agreement with contract manufacturing company for supply of unique electronic steering systems.
- Joint Ventures
  - Example: Alliance partners form a new entity to sell and to distribute over-the-counter pharmaceuticals.

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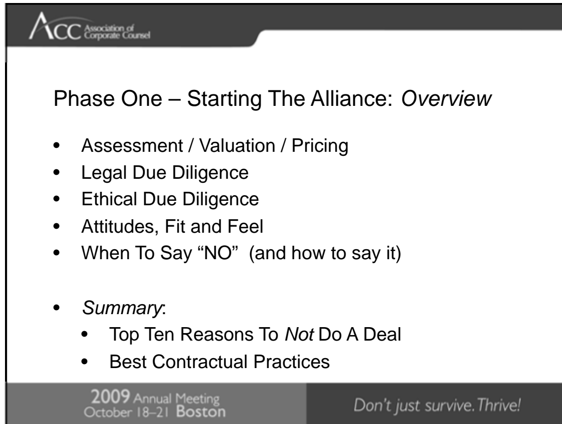

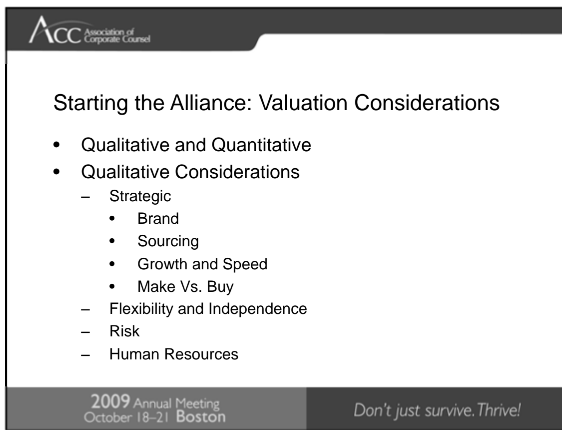

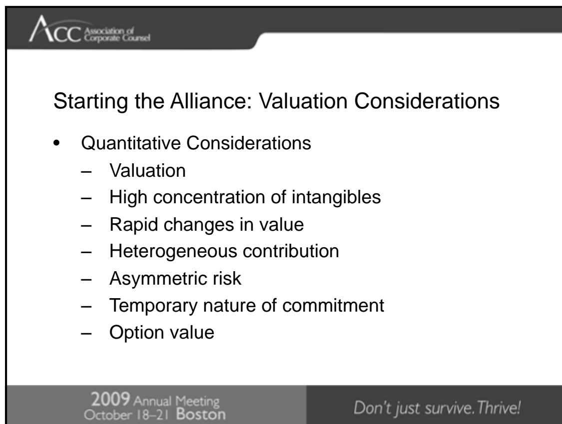

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Starting the Alliance: Look Before You Leap

- Risks: Financial, Regulatory/Legal, and Reputational
- Alphabet Soup:
  - FCPA, Money Laundering, Economic Trade Sanctions, Gray Market, Politically Exposed Persons, International Trafficking in Arms Regulations, Management Integrity, Corruption, Fraud, Environmental
- Due Diligence Process
  - External Assessment
  - Interviews
  - Background checks
  - Document Review
  - Augments financial, strategic, and other due diligence issues

Starting the Alliance: Look Before You Leap

- Legal Due Diligence "*Lite*"
  - Remember: Effective DD trumps reps and warranties
  - EDGAR, Hoovers and …… Google! (Start a "Why? List")
  - Know the Top 5 Customers, Suppliers, Products, Markets
  - Credit Agreements and Covenants
  - Permits, Licenses and Restrictive Covenants
  - IP: Patents and Trademarks
  - Judgments, Liens and Major Litigation
  - International considerations include:
    - Union claims may attach to equipment
    - Antitrust/Competition Rules

Starting the Alliance: Signs of a Lemon!

- Top 10 Reasons Not to Form an Alliance
  - Timing: Window of Opportunity Disappearing Rapidly
  - Distraction: Other Major Reorg/Acquisition Underway
  - Limited Buy-In: Only the CEOs Are On Board
  - Champion/Critical Persons Retire or Resign
  - Inordinate Investment Required to Upgrade Process Technologies or Fund Inventory
  - Incompatible Business Processes/Platforms
  - Morphs into a 'Transaction': Price swamps the discussion
  - Answers to "Why? List" aren't forthcoming
  - DD Lite Results Are Concerning
  - "Our cash burn rate…." is uttered by the other company

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Starting the Alliance: Signs of a Lemon!

- Four More Reasons Not to Form an Alliance
  - Attitude Mismatch
  - Values Mismatch
  - *Perceived* Lack of Parity
  - **Your Ability to Do A Deal is a Limited Resource!**

Phase One – Starting The Alliance:

Best Contractual Practices

Phase Two – Continuing The Alliance: *Overview*

- Integration
- Implementation and Operations
- Monitoring
- Key Issues
  - Intellectual Property
  - Compliance
- *Summary:* Best Contractual Practices

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Continuing the Alliance: Integration

- Order & Procurement Systems (MRP/EDI)
- Supply Chain Buy-In
- Distribution
- Quality Systems
- Warranty and Service Functions
- Finance/Accounting: Revenue/Cost Sharing
- Safety and Environmental Programs
- Compliance Programs

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Continuing the Alliance: Operations

Who Does What?

- Broad guidelines v. detailed cookbook
- Passive voice v. active voice
- Vetted roles v. assumed roles

Pick a paradigm…

- Ease of agreement v. ease of operations ("Pay me now" v. "Pay me later")

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Continuing the Alliance: Monitoring

- Transparency: metrics, tracking, and milestones
- Systems
- Flexibility including exit considerations
- Frequent communication; steering committees
- Periodic reassessments
- Audit rights
- Third party expertise

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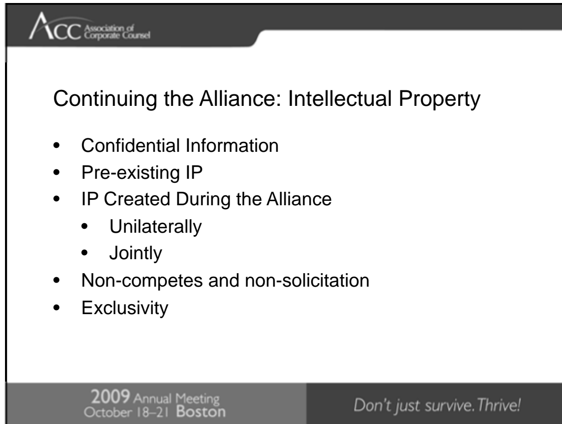

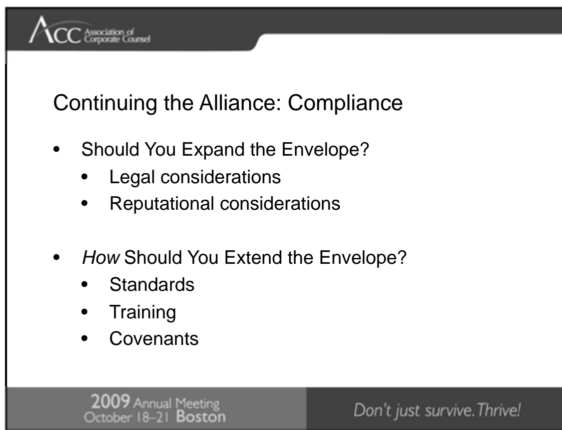

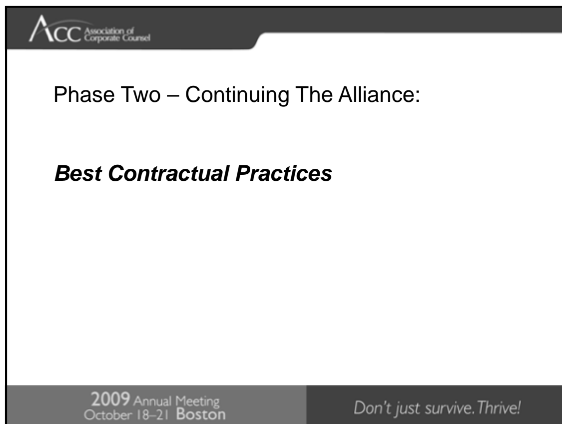

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Phase Three – Ending The Alliance: *Overview*

- Cash Issues and "The Deadbeat Partner"
- Breach and Termination
- The Tail
- *Summary:* Best Contractual Practices

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Ending the Alliance: Thoughts at the Start

- Always think win-win, and…..
- Always keep the end (exit strategy) in mind.
- 3 Common Scenarios:
  - Alliance Partner Running Out of Cash
  - Alliance Partner Terminates for Convenience
  - Alliance Partner Breaches

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Ending the Alliance

- Alliance Partner Running out of Cash
  - Exercise ownership/contractual rights regarding IP and other critical assets (special tooling) to carry on business
  - Beware of Potential Counterclaims – If possible, reduce account to promissory note with payment plan
  - Immediately issue demand for adequate assurance letter
  - Terminate Alliance/Supply Agreement - think 'transactional'
  - Go to 'Preference Mode' – Manage in 90 day increments to maximize new value/ordinary course defenses
  - Engage Business/Program Continuity Plan
  - Note: Ensure that Sales, Finance and Executive Leadership are aligned

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Ending the Alliance

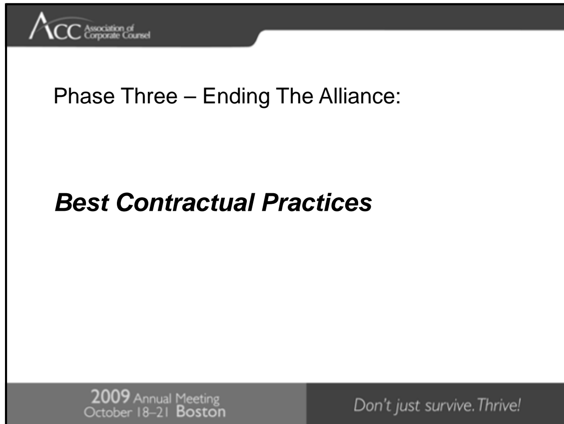
- Alliance Partner Terminates for Convenience
  - Exercise ownership/contractual rights regarding IP and other critical assets (special tooling) to carry on business
  - Alliance Partner views your company as non-strategic
  - Firm up any outstanding payment obligations (e.g., material authorization agreements, promissory notes) while Alliance Partner still needs your company. This is time critical!
  - Transition of business plan is common
  - Manage your client's ego! - Notice of termination for convenience is nothing personal.

Ending the Alliance

- Alliance Partner Breaches (Materially)
  - Exercise ownership/contractual rights regarding IP and other critical assets (special tooling) to carry on business
  - Issue Notice of Termination of Alliance/Supply Agreement
  - Beware of Potential Counterclaims – Issue internal litigation hold if necessary to preserve documents
  - Engage Business/Program Continuity Plan
  - Note: Ensure that Sales, Finance, Public Relations and Executive Leadership are aligned

Ending the Alliance: "The Tail"

- Post-termination duties / operations
  - To each other
  - To existing customers
  - To unilaterally-declared new customers?
- Post-termination payments
  - Provision = early warning sign
  - Cause v. no-cause
  - Audit rights



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Foreign Corrupt Practices Act: A growing factor in M&A

Ed Rial

Introduction: The importance of FCPA due diligence

With more companies seeking growth through cross-border mergers and acquisitions and with the unwavering intolerance of U.S. regulators and, to a growing degree, foreign regulators on corrupt practices such as bribery, making efforts to determine a target company or partner's compliance with the U.S. Foreign Corrupt Practices Act (FCPA) and local anti-corruption laws has become crucial to M&A due diligence.

The FCPA makes it a crime to bribe foreign officials to "obtain or retain" business, although the statute has been interpreted expansively to include the improper receipt of some form of business advantage. For example, making payments or providing some form of value to a foreign official to improperly reduce corporate tax liabilities has been found to violate the statute. The law's jurisdiction is very broad and covers U.S. companies, their employees, officers, directors, agents and foreign subsidiaries, as well as foreign firms operating in the U.S., and to both foreign and domestic issuers of U.S. securities. The law also requires companies to maintain accurate records and adequate internal accounting controls and holds them responsible for the books and records and controls failures of majority owned subsidiaries, even without actual knowledge of the violation. Lastly, a wide range of individuals may be considered "foreign officials," from government ministers to relatively low-level employees of state-owned enterprises.

The FCPA challenge is particularly acute for international acquirers as they risk successor liability for the acquired company's pre-closing FCPA violations. Again, ignorance has not been an accepted defense; the U.S. Department of Justice and Securities and Exchange Commission have stressed in numerous public announcements that buyers must be cognizant of corruption risk in their acquisitions and investments and conduct adequate diligence procedures to address that risk .
While infractions discovered during due diligence can affect timing, price and even the completion of a transaction, breaches detected after the close can be more damaging because of potential regulatory enforcement actions, civil penalties, the disgorgement of profits from projects obtained through bribes, ongoing liabilities and hard-to-measure reputational harm.

For much of its thirty years, the FCPA has been a sleepy statute. This changed after 2001 with the anti-fraud climate ushered in by Enron, WorldCom and other corporate scandals. The ensuing Sarbanes-Oxley Act of 2002 required stronger controls, better disclosure, and clearer accountability by top management for the accuracy of their firm's financial statements.

FCPA enforcement also gained momentum as the Department of Justice, with its responsibility for criminal enforcement, and the Securities and Exchange Commission, with its civil oversight, began working more closely together to pursue violations. New cases have been surging with about a third of the hundred plus bribery cases in the FCPA's history occurring in the last six years. There has also been a steady increase in fines and penalties, a trend which is expected to continue given the number and size of cases currently under investigation.

International cooperation between regulators – critical to pursuing investigations where evidence is frequently resident in foreign countries - is increasing. This collaboration is supported by the fact that more countries—thirty seven now in all—have signed the Organization for Economic Cooperation and Development "OECD" Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Signers are obligated to enact national legislation prohibiting foreign bribery and to offer each other legal assistance in prosecutions. Other treaties, such as the United Nations Convention Against Corruption, have found support across numerous countries, and are reflective of the increased attention being paid to corruption issues in the international arena.

Responding to this intensifying global regulatory scrutiny may make complying with the FCPA appear daunting, but adopting a tiered, risk-based approach will should assist buyers in better understanding and intelligently addressing the transaction's potential corruption risk.

Taking a risk-based approach to FCPA due diligence

Clearly making FCPA an integral part of the M&A due diligence process will help mitigate the potential FCPA problems, especially when conducted early in the transaction process. Initially, a few steps can be taken to better understand any potential FCPA risks by searching public records, including business registration filings, news accounts, publicly-available financial data, government reports, civil and criminal litigation filings, even when they are unavailable electronically. Politically-exposed-persons and regulatory databases can also help. In addition, especially where public records are sparse, valuable information can be gleaned from speaking to locals in the target's country, to sources within the buyer's own legal or compliance departments, and to thirdparty vendors.

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Such a top-down assessment can provide solid information that will help to protect against acquiring another firm's FCPA liability. And even if a violation surfaces later, at least since the buyer will have a sound basis to claim that it made a best and reasonable effort, it will tend to fare better with the regulators. For instance, one company's prompt investigation and government disclosure of its payment of bribes in several countries, and its quick remedial action in implementing a compliance program, allowed it to avoid prosecution as long as it remains bribery free for eighteen months and allowed it to avoid having an outside compliance monitor with the authority to potentially turn the company upside down looking for improper conduct.

Optimally in its FCPA due diligence, an acquiring company or merger partner will have access to internal company documents and to company officials and employees who will answer questions and help with probes into any corrupt practices. Examining records of disbursements and following an audit trail of payments tied to invoices and approvals can provide important insights as can looking into the probity of advanced or offshore payments.

Whatever the level of granularity of the investigation, FCPA due diligence requires first determining where the target company stands in a number of areas and then conducting targeted transaction testing.

Key FCPA due diligence activities

When beginning FCPA due diligence, the initial inquiries should focus on high level considerations such as

- The amount, type and quality of international, particularly those to government entities sales;
- industry and country
- The degree and nature of third party involvement in such sales; and
- The target's anti-corruption compliance programs, policies and procedures.

Assessing the amount, type and quality of international sales of the target company or partner is a good starting point to determine the level of FCPA risk and the potential need for additional procedures, including the testing of those sales and associated costs. Relatively high volumes of government sales should indicate the need for further investigation. Bribes can also be more prevalent in certain industries and countries.

An historical review of enforcement actions illustrates that no industry is exempt, some have a longer history of FCPA issues than others, which should merit giving special attention to FCPA concerns when acquiring a company in these areas. Such industries include construction, public works, arms, defense, power, mining, energy, health care, life sciences, telecommunications, civilian aerospace, finance and agriculture.

Some countries are perceived as having a higher prevalence of bribery as part of doing business. While Russia, China and various African nations tend to have high perceived levels of corruption risk, Somalia, Myanmar, Iraq, Haiti and Uzbekistan topped Transparency International's Corruption Perception Index for 2007 (TICPI index). This index can be used in the due-diligence process to help identify regions that might require more focused FCPA testing.

Understanding the degree and type of third party involvement helps narrow the search for any problems since it tends to be a locus for potential FCPA violations. Use of agents, consultants and distributors requires scrutiny into the amount paid in retainers, commissions or for other expenses in connection with sales. Equal scrutiny should be applied to sales through foreign subsidiaries or joint ventures.

It is also important to examine how international consultants are paid and whether the proper contractual terms are in place to protect against FCPA problems. The target company should have a written agreement for every international consultant covering FCPA/anti-bribery and local anti-corruption law representations, provisions for short-notice termination without cause or upon a reasonable belief of FCPA violations, prohibitions on the use of subagents without prior written approval, requirement of payments in countries in which the services are performed and audit rights.

The percentage of commissions paid to international consultants is another barometer of possible flouting of the FCPA. Higher than reasonable commission payments are a common method of passing funds through agents or distributors to relevant government officials. Also, payments to consultants or distributors should be scrutinized to determine if the payments made are consistent with the contractual terms and the payments received proper authorization and are appropriately documented. Finally, it is also critical to determine the extent of due diligence performed by the target on consultants at the time the relationship with the target company began and whether that due diligence is well documented and updated

Verifying a strong culture of compliance is beneficial since a company with the appropriate "tone at the top" accompanied by rigorous FCPA policies, processes, and procedures is less likely to harbor violations. A strong culture of compliance should include having an FCPA ethics code, compliance policies and mandatory and yearly training programs for all employees and consultants.

These key FCPA due diligence considerations should help identify activities of the target company that require closer scrutiny and testing.

Targeted transaction testing

Targeted transaction testing is another crucial component of the FCPA due-diligence process. It involves reviewing specific accounts that are commonly used to make illicit payments. This transaction testing may be accomplished by electronic data anomaly testing or manual testing to identify potential suspect transactions followed by a careful examination of supporting documents. Such accounts typically include donations, commissions, facilitation payments, incidentals, contributions, bonuses, foundations, licenses, entertainments, consultant fees, gifts, miscellaneous items, promotions, travel expenses, marketing costs, sponsorships and lobbying fees.

During transaction testing a sharp lookout also should be kept for such items large one-time payments to vendors round dollar invoices, duplicate names, payments and invoice numbers, sequential invoice numbers, invoices with the same date and vendor, disbursement to countries where the company does no business, disbursement to places other than the vendors place of business, manual checks or wire transfer payments to target countries, manual payments, payments or line items with unusual or no descriptions and payments to employees through such means as bonuses and cash advances.

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Expense reports for selected employees should be reviewed as part of the testing process especially for those who interact with lobbyists or government officials and for those with annual expenditures above a determined threshold amount. The focus should be on travel, entertainment and gifts.

Conclusion

Conducting FCPA due diligence is increasingly critical to the success of a merger, acquisition or joint venture with companies operating internationally given the heightened scrutiny by the Department of Justice and the SEC and the greater likelihood of successor liability.

Acquirers must understand a target's FCPA risks and mitigation procedures. Historical conduct can serve as a guide as can a careful assessment of public records and sources. A more in-depth approach using company records and sources is preferred where possible, but some benefit can be gained from a less extensive and expensive investigation.

If problems are uncovered before a transaction's close, remedial action can be taken and the deal can even be restructured to compensate for potential reputational damage and successor liability. That said, sometimes deals fall apart based on FCPA concerns. For instance, a few years ago, a major U.S. defense contractor walked away from a cross-border acquisition because undisclosed FCPA issues that arose in the course of due diligence were not able to be resolved with the government to the contractor's satisfaction in a timely manner.

After a deal is closed, immediate efforts should be made to integrate the acquired company's FCPA compliance procedures and processes

Simply put, FCPA can no longer be ignored. The government is very clear in saying that a company can't stick its head in the sand. It has to look. If it doesn't, then it is on the hook.

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Look before you leap
Managing risk in global investments

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A Message from Wendy Schmidt and Joe Zier

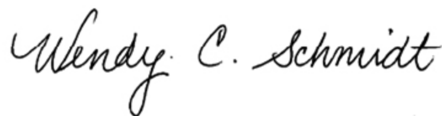
We are pleased to present the annual Look Before You Leap survey on how companies are using background/integrity checks to better manage the risks inherent in investments and new business relationships outside the United States. In addition, this year's survey also addressed how companies are complying with the U.S. Foreign Corrupt Practices Act (FCPA) and the challenges they face.

This year's survey shows us that companies appear to be increasingly focused on assessing and managing the risk in their international relationships, but many seem to be struggling to do so at a reasonable cost. To gain greater insight into whom they are doing business with, background checks are progressively becoming the norm — conducted at least some of the time by 89 percent of the survey participants — and will be viewed as expected baseline controls by the regulators in the next year.

Survey results also highlighted that companies that conduct background investigations, and do so effectively, may be able to avoid significant problems that may otherwise have gone undetected in the due diligence process. In fact, more than half of the survey respondents said their companies had renegotiated or cancelled a planned investment or business relationship outside the United States based on the findings of a background investigation.

The increased focus by management on these issues appears to have been spurred by a more aggressive regulatory environment. In this year's survey, three-quarters of the survey participants said they had become more concerned about the potential for FCPA violations, with the greatest concern about their activities in emerging markets such as Russia, Africa, China, and the Middle East. The potential for significant regulatory risk, the need to install robust internal controls and conduct additional, effective due diligence were some of the key issues identified as a result of Deloitte's[1] recent investigative work for Siemens AG, which agreed in 2008 to pay fines totaling $1.6 billion to U.S. and German regulatory authorities due to anti-corruption violations.

In our practice each day, we see that companies with robust due diligence and strong internal controls are usually less likely to encounter unforeseen problems in their overseas business activities. We hope that this 2009 Look Before You Leap survey will help your company as it manages these complex issues.



Wendy Schmidt
National Leader, Business Intelligence Services
Deloitte Financial Advisory Services LLP

Joe Zier
Partner, Forensic & Dispute Services
Deloitte Financial Advisory Services LLP

[1] As used in this instance, Deloitte refers to Deloitte & Touche GmbH and the 35 member firms of Deloitte Touche Tohmatsu that participated in the Siemens AG investigation.

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Executive summary

This third edition of Deloitte's[2] *Look Before You Leap* survey focused on the use of background/integrity checks when considering a business relationship, investment, or acquisition outside the United States.[3] In addition, it analyzed in detail the steps companies are taking when active in foreign markets to help comply with the U.S. Foreign Corrupt Practices Act (FCPA).

The survey found that investigating these issues has had a major impact on many company business plans. More than half of the 200 survey participants surveyed said that issues identified in background/integrity checks over the last three years had led their companies to renegotiate or cancel a planned business relationship, investment, or acquisition outside the United States. Similarly, 42 percent of the survey participants said their companies had cancelled or renegotiated a planned business transaction outside the United States over the last three years due to concerns over compliance with the FCPA.

And concerns over compliance with the FCPA appear to be increasing. Seventy-five percent of the survey participants surveyed said that over the last three years companies in their industry had become more concerned over the potential for FCPA violations, with the greatest concern about potential violations in emerging markets such as Russia, China, and the Middle East.

Despite the high level of concern about maintaining FCPA compliance, however, only about one-fifth or fewer survey participants said their companies conduct detailed investigations into a series of potential FCPA problem areas — such as whether certain compensation to third parties is appropriate or whether the target company has a system to identify anomalous transactions — before entering into a business relationship outside the United States.

In working with clients in many industries, Deloitte has found that companies can benefit from proactive programs that probe deeply into the backgrounds and past activities of potential partners to identify any allegations of bribery, corruption, criminal activity, or other inappropriate behavior. When conducting such due diligence, companies should consider looking at a variety of sources, including public records, local media, Internet searches, and interviews with people knowledgeable about the local market. Companies should also consider evaluating the effectiveness of any anti-corruption compliance programs in the local companies that they are seeking to acquire or do business with.

Companies that fail to take these steps may run the risk of violating the FCPA and other laws, and could potentially be subject to significant penalties. In addition, the discovery of inappropriate or illegal behavior on the part of foreign business partners can lead a company to suffer significant damage to its corporate reputation. As U.S. companies continue to expand around the world, especially in emerging markets, putting in place effective procedures designed to help identify and address potential problems with business partners and acquisition targets — both with FCPA compliance and with business integrity generally — can be a key contributor to long-term success.

[2] As used here and throughout the remainder of this document, Deloitte means Deloitte Financial Advisory Services LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

[3] The first edition of the survey was Look Before You Leap: Emerging market investments… how do you manage the risks?, Deloitte Financial Advisory Services LLP, 2006. The second edition of the survey was Look Before You Leap: Investigative Due Diligence in International Business Relationships. Deloitte Financial Advisory Services LLP, 2007.

As used in this document, "Deloitte" means Deloitte Financial Advisory Services LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

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Survey methodology

Deloitte Financial Advisory Services LLP contracted Bayer Consulting to conduct this Look Before You Leap survey to help assess how companies are managing investigative due diligence in acquisitions, investments, and business relationships outside the United States.

The survey was conducted online between May 28 and October 3, 2008. It was completed by 216 senior professionals involved with acquisitions, investments, and business relationships outside the United States for their companies. The responses were aggregated for the purpose of analysis, and individual responses have been kept strictly confidential. The survey participants came from companies representing a range of industries and sizes. (See Exhibit 1 and Exhibit 2.)

Exhibit 1
Industry

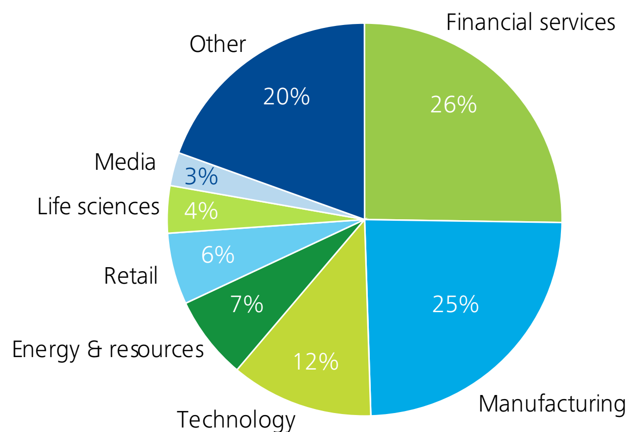
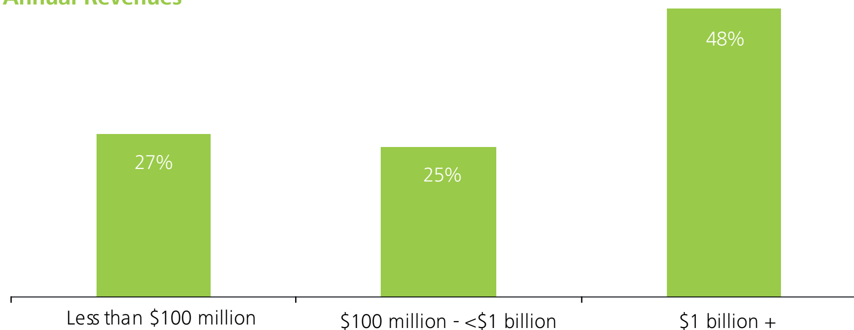


Exhibit 2
Annual Revenues



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Background/Integrity investigations

More than half of the survey participants said their companies had cancelled or renegotiated planned transactions outside the United States due to issues identified in background/integrity investigations.

There was widespread use of background/integrity investigations before business transactions outside the United States by the companies participating in the survey. Fully 89 percent of the survey participants said their companies conducted background/integrity checks of relevant parties at least some of the time before entering into a business relationship, merger, or acquisition outside the United States, while 69 percent said they always or frequently conducted such investigations.

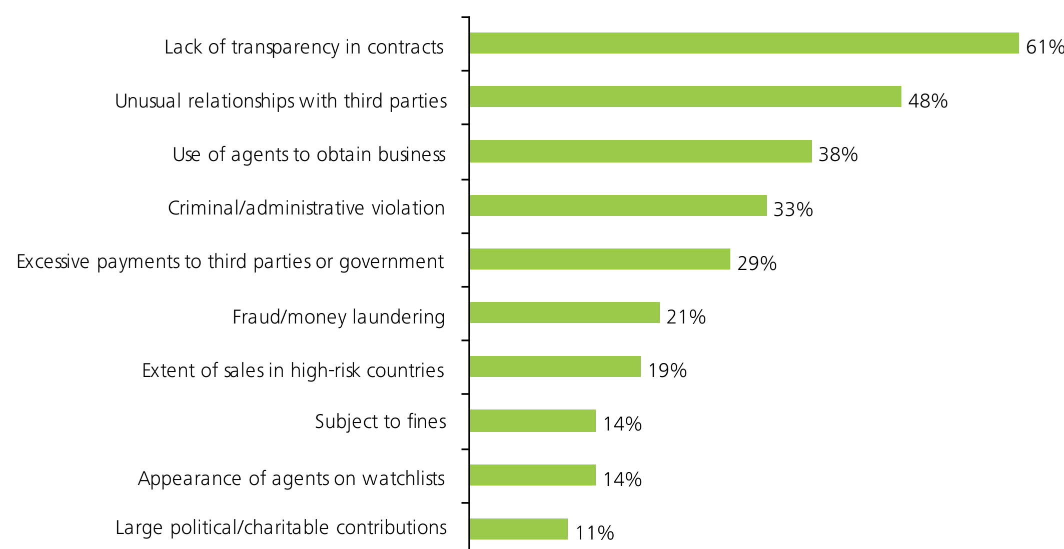
For many of the participants, these investigations have been a critical input into business decisions. Fifty-nine percent of the survey participants said that information identified in a background/integrity check had led their companies to renegotiate a planned transaction outside the United States over the last three years, while 55 percent said such information had led them to cancel one.

The most common issues that led companies to change their foreign business plans were a lack of transparency or unusual payment structures in contracts, cited as a reason by 61 percent of survey participants, and the existence of unusual business relationships between executives at the target company and government officials or third parties, cited by 48 percent of survey participants. (See Exhibit 3.) However, several other issues also caused companies to cancel or renegotiate transactions, including the use of agents, consultants, distributors, or other third parties to obtain or facilitate business (38 percent of participants) and the discovery that the entity was involved in a criminal or administrative violation from a governmental agency (33 percent of participants).

Exhibit 3

Issues identified in background/integrity investigations that led company to cancel or renegotiate potential transactions outside the United States

Base = Survey participants at companies that cancelled or renegotiated

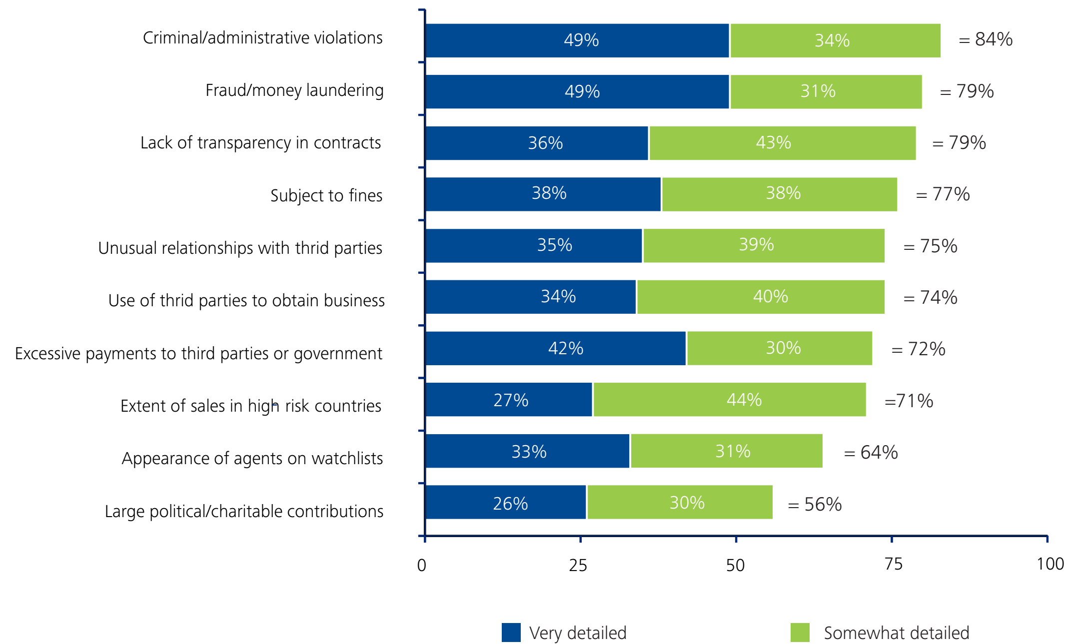


Background/integrity checks investigate a wide range of potential problems.

Survey participants were asked about the extent to which their background/integrity checks investigated a list of potential problem areas. (See Exhibit 4.) More than 70 percent of the survey participants said that eight of the 10 issues received either a very detailed or somewhat detailed investigations at their companies. The issues that most often received a very detailed investigation during background/integrity checks were the existence of criminal or administrative violations (49 percent of participants), evidence of fraud or money laundering schemes (49 percent of participants), and excessive or questionable payments to or on behalf of government officials, consultants, or other third parties (42 percent of participants).

Exhibit 4

Level of investigation into issues in background/integrity investigations



Compliance with the Foreign Corrupt Practices Act

One of the key concerns when entering into a business relationship, making an investment, or conducting an acquisition outside the United States is compliance with the Foreign Corrupt Practices Act (FCPA), which prohibits U.S. companies and their subsidiaries, as well as their officers, directors, employees, and agents, from bribing "foreign officials" in order to secure business or some other improper advantage. It also requires all SEC-registered companies to maintain internal accounting controls and to keep books and records that accurately reflect all transactions. In addition to requiring appropriate record-keeping for all transactions and dispositions of assets, the FCPA also stipulates the required levels of due diligence about individuals and entities doing business with the company.

Concerns over FCPA compliance

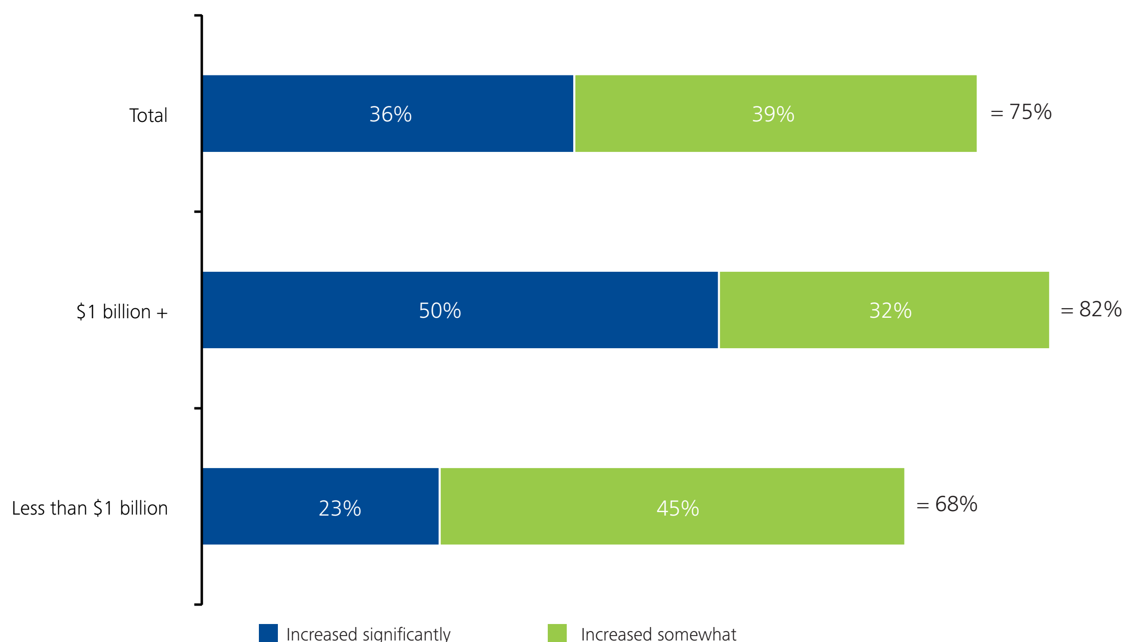
Companies are increasingly concerned over the potential for FCPA violations.

Three-quarters of the survey participants surveyed said that companies in their industry had become more concerned over the last three years about the potential for FCPA violations, with roughly one-third saying that these concerns had increased significantly. (See Exhibit 5.) The concerns about FCPA compliance are even greater among larger companies. Fully half of the survey participants at companies with annual revenues of $1 billion or more believed that the concern in their industry about potential FCPA violations had increased significantly, while 82 percent said that it had increased at least somewhat.

Exhibit 5

Increased concern over last three years about potential FCPA violations

Views of respondents about concern among companies in their industry overall



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Greatest concern about FCPA compliance is related to emerging markets.

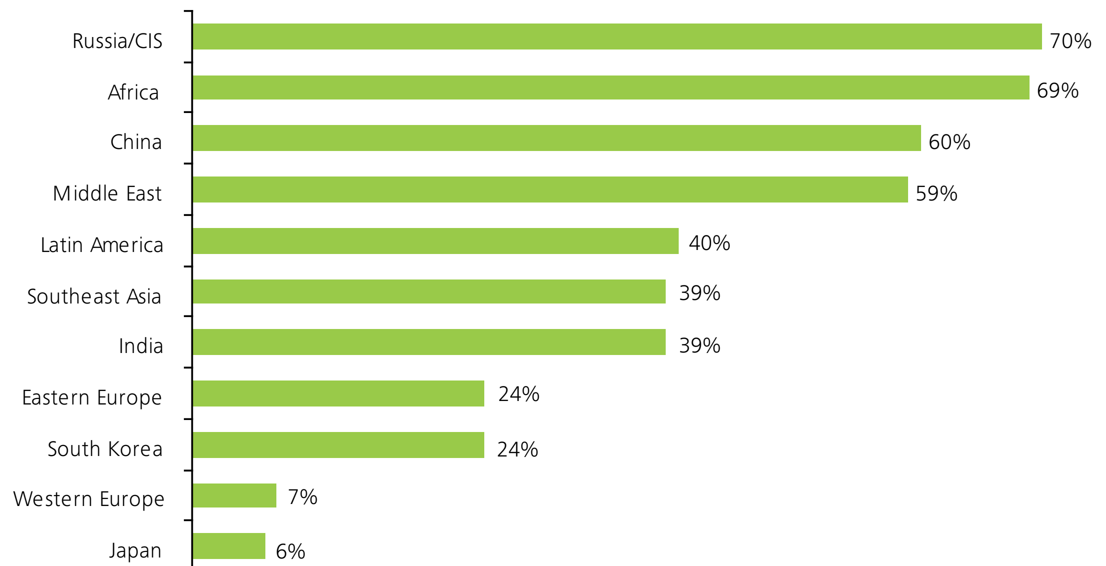
With many emerging markets having become associated with corrupt business practices, survey participants are most concerned about the potential for violations of the FCPA when doing business in these locations. When asked how concerned their companies were about the potential for FCPA violations when doing business in specific markets, survey participants were most likely to report their companies were extremely concerned about FCPA violations in Russia/CIS (i.e., the former members of the Soviet Union) (70 percent), Africa (69 percent), China (60 percent), and the Middle East (59 percent). (See Exhibit 6.) Substantial percentages of survey participants also reported concerns about Latin America, Southeast Asia, and India.

Bribery schemes are one of the sources of FCPA risk. When asked about the types of bribery schemes observed most often in foreign business environments, the schemes that were most often ranked as either first or second in frequency were subcontractors that don't add value (48 percent), inappropriate training and travel expenses (46 percent), and the use of third-party foreign payers (45 percent). Roughly one-quarter of survey participants cited intermediary price inflation and the creation of slush funds.

Exhibit 6

Concern about potential for FCPA violations in specific locations percent

Percent extremely concerned



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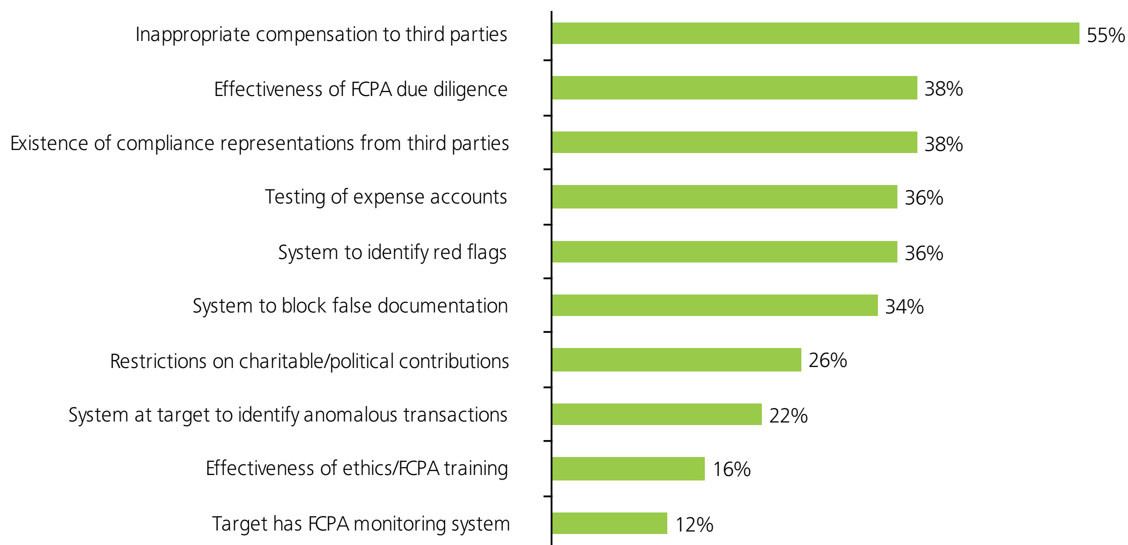
FCPA concerns often lead companies to renegotiate or cancel planned foreign transactions.
Forty-two percent of survey participants reported that concerns over FCPA compliance had led their companies to either renegotiate or pull out of a planned business relationship, merger, or acquisition outside the United States over the last three years.

Survey participants cited a long list of FCPA concerns that had contributed to these decisions. Leading the list of FCPA concerns that led to changed business plans was the appropriateness of compensation paid to international agents, consultants, and third parties, which was cited by 55 percent of survey participants. (See Exhibit 7.) However, several other issues were named by roughly one-third of survey participants as motivating their areas of concern that led to their decision, including the existence and effectiveness of FCPA due diligence/screening procedures and the existence of compliance representations from employers, agents, and other business partners.

Exhibit 7

FCPA concerns that led company to renegotiate or cancel planned transaction outside the United States

Base=Survey participants at companies that have cancelled or renegotiated transactions over last three years due to FCPA concerns



Note: Percentages total to more than 100 percent since survey participants could make multiple selections.

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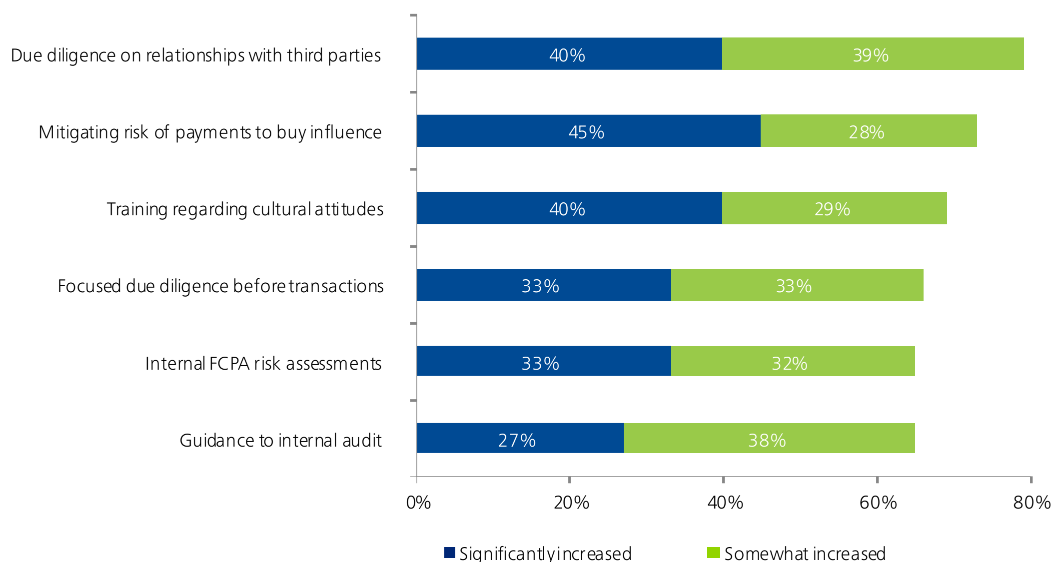
FCPA compliance programs

Companies have increased their FCPA compliance activities.
As a result of these concerns, companies appear to have increased their activity in several areas to help maintain FCPA compliance. (See Exhibit 8.) Among the areas of increased focus are due diligence on a target entity's relationships with agents, consultants, and third-party vendors and service providers, and internal controls focused on mitigating the risk of payments to third parties to obtain or retain governmental business.

Exhibit 8

Increase in activity over last three years to ensure FCPA compliance



Companies employ a wide range of FCPA compliance techniques.
Survey participants reported that their companies use a wide range of techniques to help maintain FCPA compliance. (See Exhibit 9.) Leading the list was having clearly articulated corporate policies and procedures against violations of FCPA and anti-bribery laws, cited by almost three-quarters of survey participants. Other methods used by many companies were appropriate financial and accounting procedures designed to establish an effective system of internal controls; having one or more corporate officials with responsibility for overseeing FCPA compliance; and a formal reporting system, such as a "help line" to report suspected violations.

Larger companies appeared to be much more likely to use such methods. For example, 73 percent of survey participants at companies with $1 billion or more in annual revenues said they had a formal reporting system for FCPA and 63 percent said they had appropriate disciplinary procedures to address violations or suspected violations, compared to 37 percent and 33 percent, respectively, among those at smaller companies.

Surprisingly, only about one-quarter of survey participants said their companies required annual certifications of compliance by third parties, and a similar percentage said they conducted independent audits by outside counsel and auditors at least every three years to help them in their assessment of the effectiveness of the company's compliance code, including its anti-corruption provisions .

Instead of conducting independent audits by outside counsel and auditors, 60 percent of survey participants said their companies conducted internal audits by company employees focused on the effectiveness of FCPA risk

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mitigation processes and controls. Other approaches used to test the effectiveness of FCPA controls were having outside counsel interview employees and third parties (29 percent of participants), and conducting surveys and testing of third parties on their FCPA knowledge and compliance (17 percent of participants). However, one-quarter of survey participants said their companies did not test the effectiveness of their FCPA controls, including 16 percent of survey participants at companies with $1 billion or more in revenues.

Further, there appears to be limited use of software to test for anomalies or red flags with respect to FCPA risk mitigation and controls. Only 30 percent of survey participants reported using such data analytic programs to identify potential FCPA problems, with just 4 percent saying they used them extensively.

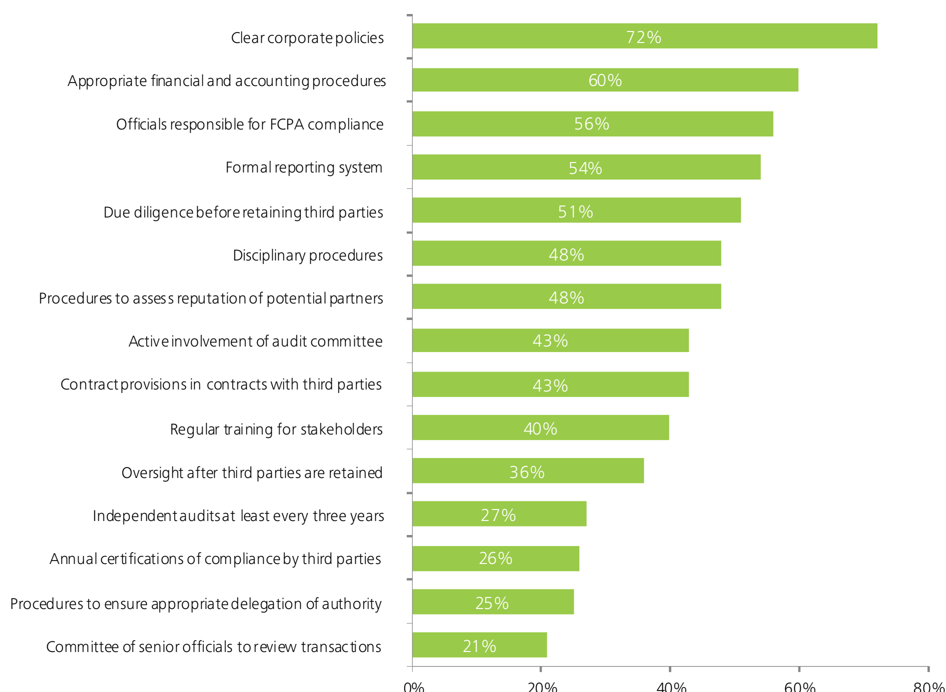
Most companies provide training to employees on FCPA issues.

A key element in any FCPA compliance program is training employees on the issues involved and how to handle them. Sixty-three percent of survey participants said their companies provided FCPA training to its employees annually or more frequently, with 87 percent of survey participants at companies with $1 billion or more in annual revenues reporting that training is provided this often.

Many functions receive FCPA training. Roughly 80 percent or more of survey participants said their companies provided FCPA training to its senior corporate management (89 percent of participants), senior business unit management (89 percent of participants), legal department (87 percent of participants), sales and marketing employees (85 percent of participants), finance (84 percent of participants), and operations (78 percent of participants).

Exhibit 9

Activities to ensure FCPA compliance



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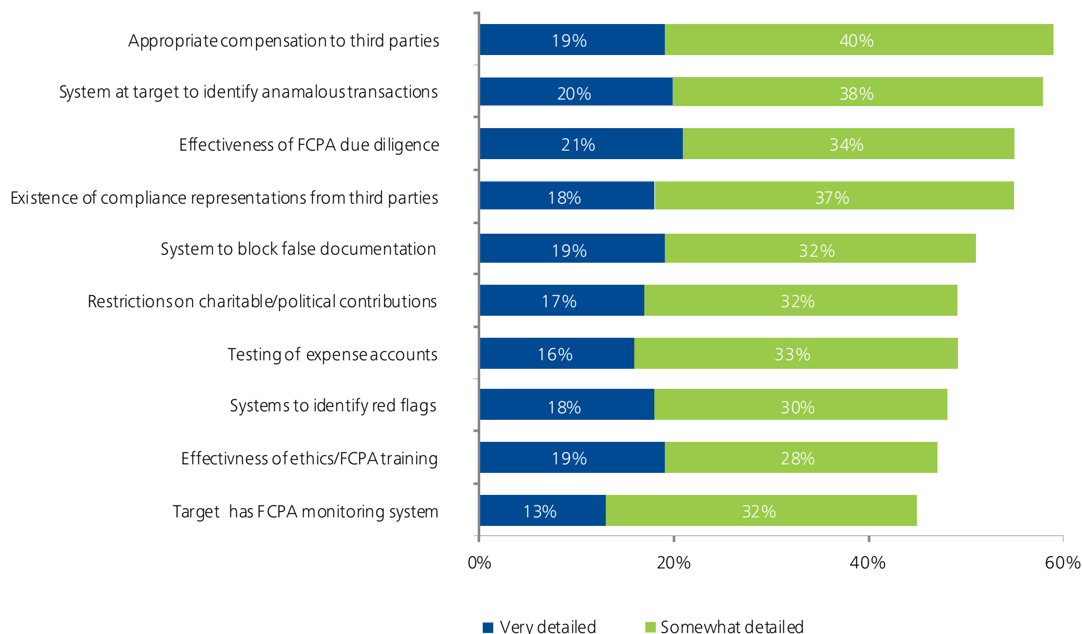
FCPA investigations

Few companies conduct detailed investigations of potential FCPA problem areas.

Surprisingly few companies conduct detailed investigations of potential problem areas. (See Exhibit 10.) Only roughly one fifth or fewer of the survey participants said their companies conducted a very detailed investigation of potential problems areas before making an investment or acquisition, or entering into a business relationship outside the United States. Further, only about one half of the survey participants said their companies conducted at least a somewhat detailed investigation of potential problem areas.

Exhibit 10

Level of detail of FCPA investigation before entering into business relationship or acquisition outside the United States



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