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DISCUSSING THE TRENDS

Q&A with Kari Chandler

Navigating FCPA Risks in Global Private Equity Ventures

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In light of the global nature of the private equity industry, minimizing Foreign Corrupt Practices Act (FCPA) risks is an important consideration for private equity firms and their portfolio companies.

Latham & Watkins counsel Kari Chandler was joined by Jeffrey Ferguson, managing director and general counsel at the Carlyle Group, and Kevin McGlinchey, general counsel for Accudyne Industries, for a webcast on navigating the FCPA risks inherent to the private equity industry. The group discussed key FCPA considerations that private equity firms need to be mindful of, offered tips on conducting thorough due diligence on potential transactions, and recommended strategies for managing FCPA risks at the portfolio company level.

In this Q&A interview, the team offers highlights from the discussion. A recording of the full webcast, "Navigating FCPA Risks in Global Private Equity Ventures," is available online until October 7, 2015.

What are some of the major FCPA considerations that private equity firms must take into account?

Chandler: Private equity firms and their portfolio companies can be subject to anti-corruption laws around the world. The FCPA is the most vigorously enforced anti-corruption law out there. In a nutshell, the FCPA prohibits companies subject to its jurisdiction, as well as their officers and employees, from directly or indirectly bribing a foreign official to obtain an improper business advantage. The FCPA applies broadly to domestic concerns, US issuers and US persons. Prosecutors often assert jurisdiction over non-US companies based on minimal ties to the US. Some other anti-corruption laws prohibit even broader contact. Notably, the UK Bribery Act prohibits commercial bribery, the acceptance of bribes, and facilitation payments.

In the private equity context, it is important to note that private equity firms can face exposure to FCPA risks, both legal and reputational, for their own activities as well as the activities of their portfolio companies. With respect to their own dealings, private equity firms often deal directly with state-owned banks and sovereign wealth funds in their own operations. Employees of these entities are considered to be "foreign officials" for FCPA purposes, and dealings with such individuals could expose firms to FCPA risks. In addition, the FCPA applies to indirect bribery, which in the private equity context could put relationships with finders and placement agents under scrutiny.

How should FCPA considerations factor into potential private equity transactions?

Ferguson: You of course want to acquire a well-run business with a good management team that has high integrity. So, it is a basic proposition that you should do effective due diligence. This is particularly important because private equity firms can face successor and ongoing liability for the acts of a portfolio company depending on the private equity firm's level of knowledge and control over the portfolio company.

FCPA issues found during diligence can impact the valuation of the deal. The value of the deal may be lower if lucrative contracts obtained through bribery need to be terminated. FCPA compliance issues can also impact the price private equity firms receive for the portfolio company in the event of a future divestiture. Finally, firms may want to negotiate to include termination and indemnification protects in the governing deal documents.

How should FCPA risks be managed at the portfolio company level post-acquisition?

McGlinchey: Tone at the top at the portfolio company level is absolutely critical. During that initial 90 to 100 days after

the deal, there is a lot going on. You may have a new executive team, or you may have an existing executive team. You may have a really healthy culture from the standpoint of compliance, or you may have a culture that needs some improvement and support. I really can't stress enough that having a strong tone at the top where the sense is "this is the way we are going to operate" solves a lot of problems, and the absence of it can cause a lot of problems regardless of how well written your policies and procedures are.

In terms of the compliance program, I think it's helpful to recognize that every company is different, and there is no "one-size-fits-all" approach. You could have a carve-out from a very sophisticated, highly regulated US business, or you could have a small, standalone company that hasn't historically been subject to these laws. So you need to get in and assess very quickly where you stand and prioritize what you need to do. There is a lot benefit to tailoring your program to the specific risks, such as the countries you operate in, your level of interaction with government officials, and the nature of your work as much as you can.

How can private equity firms promote compliance at the portfolio company level?

Chandler: A comprehensive risk assessment is key. It is important to review the diligence report to identify the gaps, to develop a strategy to close those gaps, and to make sure the gaps are closed within a reasonable time following closing. Training is also crucial. You may have private equity firm personnel on the board of the portfolio company, so training those individuals is particularly important because they likely have insight to the portfolio company's conduct that could present FCPA risks.

Ferguson: The firm should also consider the level of oversight it will have over the portfolio company. You may want to get periodic certifications by the portfolio company board members and management team that they are taking the appropriate compliance measures, or receive monthly reports from fund managers on compliance matters and issues reported through the company's internal hotline. Failure to take these steps may catch up with you at the divesture phase, impacting valuation or even precluding the sale altogether.

More Information

Listen to a full recording of the "Navigating FCPA Risks in Global Private Equity Ventures" webcast.

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