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Private Equity and the FCPA: Deal-Making as Reform Mechanism

Thomas J. Manning*

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I. INTRODUCTION

Acme Inc., an emerging market operating company owned by your Private Equity (PE) firm, has been performing admirably—every year its market share increases, driven by a winning product and a sales department that is expensive but effective. Then a request from the DOJ arrives, demanding an itemized accounting of Acme's sales expenses. Worse yet, when you examine Acme's expense reports you find documentation that is incomplete in some places and troublingly vague in others, but indicates substantial contact with government officials. Acme's results have always justified its expenses, but now the portfolio company threatens to saddle its investors with a long and costly investigation that could result in reputational damage, steep civil fines, and even criminal penalties.

Since passage of the Foreign Corrupt Practices Act of 1977 (FCPA), the preceding scenario has become an increasingly plausible one. The FCPA prohibits the payment of bribes to foreign officials for the purpose of obtaining or retaining business,[1] and further mandates certain recordkeeping

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1. 15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3 (2012).

and internal control standards designed to thwart such payments.[2] The law applies to any U.S. citizen, national, or resident; any entity incorporated in the U.S. or with its principal place of business in the U.S.; and any issuer with securities registered in the U.S. or otherwise required to file reports with the SEC.[3] In the event of a violation, the FCPA authorizes both criminal and civil penalties, including up to twenty-year prison terms for certain willful offenses,[4] and many reports indicate enforcement efforts have increased in recent years.[5]

Though the FCPA has been the source of understandable alarm in the U.S. investment community,[6] the DOJ and SEC (the law's two enforcing bodies) have yet to bring an FCPA action directly against a private equity firm.[7] Meanwhile, PE firms have continued to invest in environments that

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2. 15 U.S.C. § 78m (2012). This section of the FCPA—commonly referred to as the "books and records" provisions—applies only to issuers. *Id.*; *see also The New FCPA Resource Guide: Enhanced Insight on Books and Records, Internal Controls, and M&A Due Diligence*, PWC (2013), http://www.pwc.com/en_US/us/forensic-services/publications/assets/pwc-white-paper.pdf.

3. *See* 15 U.S.C. §§ 78dd-1, 78dd-2(h)(1)(A) (2012). Section 78dd-3 applies to legal entities and natural persons "while in the territory of the United States."

4. 15 U.S.C. § 78ff (2012) (specifying that "[a]ny person who willfully violates any provision of this chapter (other than section 78dd-1 of this title) . . . shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years").

5. *See, e.g.*, Benjamin Gruenstein, *Upswing in FCPA Cases Results In Increased Judicial Oversight*, NEW YORK LAW JOURNAL (Jul. 8, 2013), http://www.cravath.com/files/Uploads/Documents/Publications/3420723_1.pdf ("From 2008 through May 2013, the Department of Justice (DOJ) charged over 80 individuals with violating the FCPA, over twice the number that was prosecuted in the 10 preceding years."); Amanda N. Persaud, *The FCPA and Private Equity: Important Considerations in an Increasingly Active Regulatory Environment*, WACHTELL, LIPTON, ROSEN & KATZ (Jul. 2012), http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.21864.12.pdf ("There has been a substantial increase in enforcement of the FCPA in the last five years. The FCPA's two enforcement agencies, the DOJ and the SEC, have significantly bolstered resources and staff dedicated to enforcement of FCPA violations.").

6. *See*, *e.g.*, Michael Li-Ming Wong et al., *The Private Equity Trap: How Global Anticorruption Can Ensnare the Unwary Private Equity Professional*, 17 J. PRIVATE EQUITY 50 (2013), *available at* http://www.gibsondunn.com/publications/Documents/PrivateEquityTrapWongDavisAustin.pdf ("The combination of increasingly assertive enforcement agencies, novel theories of FCPA liability, expansion of whistleblower protection and monetary incentives under Dodd-Frank, and the emergence of aggressive international anti-corruption laws has produced an enforcement environment in which private equity firms can blindly fall into liability based on the corruption of others."); G. Derek Anderson et al., *Private Equity: Blindsided by the FCPA—Hedging Against Anti-Corruption Deal Risk*, PILLSBURY WINTHROP SHAW PITTMAN LLP (Feb. 28, 2013), http://www.pillsburylaw.com/siteFiles/Publications/AlertFebruary2013LitigationPrivateEquity_BlindsidedbytheFCPAHedgingAgainstAntiCorruptionDealRisk.pdf ("Until a few years ago, private equity firms enjoyed relative insulation from regulatory scrutiny of overseas acquisitions and the operations of multi-national portfolio companies. No longer is that the case.").

7. *See*, *e.g.*, Amy L. Riella & Kristen M. Shepherd, *Private Equity Gets the FCPA Limelight*,

struggle with corruption, such as China, India, and Brazil.[8] This ongoing investment—coupled with the lack of successful enforcement actions—seems to contradict the business and legal communities' expressed anxiety regarding FCPA liability. Indeed, some investors may sense that certain aspects of PE investment work to insulate it from FCPA liability: for example, PE by its nature maintains separation between investor and local operator, and many emerging market PE projects cast the investor in a minority role.[9]

Notwithstanding these observations, we believe the PE community has in fact responded to a very real threat of FCPA prosecution by developing a substantial degree of FCPA compliance. Our analysis of enforcement activity indicates a pattern of PE acquisitions followed by FCPA-related amelioration, often including the voluntary reporting of possible issues to the DOJ and SEC. However, this encouraging trend may mask a problematic one, that of PE investors avoiding risk of FCPA liability by foregoing otherwise attractive investment opportunities, thereby ceding opportunities to investors outside the FCPA's jurisdiction. Accordingly, we urge government regulators to allow PE investors greater latitude for imperfect post-acquisition compliance when such imperfect compliance is coupled with substantive remedial action.

LAW360 (Nov. 1, 2013), http://www.velaw.com/uploadedfiles/vesite/resources/privateequitygetsfcpalimelight.pdf (noting that the DOJ and SEC have not "successfully prosecuted a single private equity firm for FCPA violations").

8. *See, e.g.*, *2012 EM PE Annual Fundraising and Investment Review*, EMERGING MARKETS PRIVATE EQUITY ASSOCIATION 6 (Apr. 1, 2013), http://www.empea.org/research/data-and-statistics/2012-em-pe-annual-fundraising-and-investment-review/ (reporting that the 2012 PE investment in China, India, and Brazil was $7.10 billion, $2.68 billion, and $4.38 billion, respectively). According to Transparency International's corruption perception index, China ranks 80th out of 177 nations with a score of 40 out of 100 (where 0 means a country is perceived as highly corrupt and 100 means it is perceived as very clean). *Corruption Perceptions Index 2013*, TRANSPARENCY INTERNATIONAL, http://www.transparency.org/cpi2013 (last visited Jan. 25, 2015). India is ranked 94th with a score of 36, and Brazil is ranked 72nd with a score of 42. *Id.* By way of comparison, the U.S. is ranked 19th with a score of 73, and Denmark and New Zealand are tied for first with a score of 91. *Id.*

9. *The World of Private Equity: A Battle Over Value*, KNOWLEDGE@WHARTON (May 1, 2010), http://kw.wharton.upenn.edu/private-equity/seminar/the-world-of-private-equity-a-battle-over-value/ ("In a growth capital investment, the private equity firm may take a minority role, contributing capital and guidance to help the company grow.").

II. OVERVIEW OF FCPA ENFORCEMENT BEARING ON PRIVATE EQUITY

Over the last five years alone, the DOJ and SEC have brought FCPA enforcement actions against such well-known companies as Archer Daniels Midland, Tyco, Oracle, Allianz, IBM, and Johnson & Johnson.[10] From 2009 to 2014, 68 corporations paid a total of almost four billion dollars in fines,[11] while 77 individuals were also criminally charged, resulting in prison terms of up to fifteen years.[12] Notwithstanding this considerable volume of enforcement activity, a PE firm has yet to face prosecution under the FCPA since the law's passage in 1977.[13] That said, there has been PE-related enforcement action on the periphery, including (1) prosecution of PE-owned operating companies,[14] (2) instances of self-reporting and investigation without findings of wrongdoing,[15] and (3) reports of government investigations into PE firms themselves.[16]

DOJ and SEC actions against PE operating companies arguably represent PE's closest encounter with formal FCPA enforcement to date. However, these enforcement actions have primarily focused on pre-acquisition activity and generally find the PE firm in something of a corrective role, with the identification and resolution of FCPA violations occurring shortly after the PE acquisition.[17] PE firm Cherington Capital's acquisition of defense contractor Pacific Consolidating Industries (PCI) offers one such example.[18] After purchasing PCI in 2003, Cherington discovered during a post-acquisition audit that Leo Winston Smith, a former PCI executive vice president and director of sales and marketing, had made

10. *SEC Enforcement Actions: FCPA Cases*, SEC.GOV, http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml (last updated Oct. 27, 2014).

11. *FCPA Digest: Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act*, SHERMAN & STERLING LLP 2–3 (Jan. 2014) [hereinafter *FCPA Digest*], *available at* http://www.shearman.com/~/media/Files/Services/FCPA/2014/FCPADigestTPFCPA010614.pdf.

12. *Id.*; Richard L. Cassin, *A Survey of FCPA Sentences*, THE FCPA BLOG (Feb. 28, 2013), http://www.fcpablog.com/blog/2012/2/28/a-survey-of-fcpa-sentences.html.

13. *See SEC Enforcement Actions: FCPA Cases*, *supra* note 10.

14. *FCPA Digest*, *supra* note 11, at 2–3.

15. *See, e.g.*, Eric Hornbeck, *DOJ Drops FCPA Probe Into DynCorp*, LAW 360 (Mar. 29, 2013), http://www.law360.com/articles/428520/doj-drops-fcpa-probe-into-dyncorp.

16. *See* Riella & Shepherd, *supra* note 7.

17. *See, e.g.*, Chip Roh et al., *Private Equity Alert: Ignorance of the FCPA is No Excuse*, WEIL GOTSHAL (Feb. 2008), http://www.weil.com/~/media/files/pdfs/privateequityalert_feb08.pdf (discussing PE firm Cherington Capital's acquisition of Pacific Consolidating Industries).

18. *Id.*

suspicious payments to the U.K. Ministry of Defense.[19] Cherington then reported the matter to the DOJ and cooperated in its ensuing investigation,[20] which concluded with Smith pleading guilty to FCPA and tax charges.[21]

A similar example of voluntary disclosure is evident in the acquisition of ABB's upstream oil and gas businesses by PE investors Candover, 3i and JP Morgan Partners. The PE consortium made the acquisition in July 2004, organizing the ABB entities under holding company Vetco International, Ltd.[22] At the time of the acquisition, two Vetco entities pleaded guilty to FCPA violations in Nigeria, ABB settled a related SEC enforcement action, and the PE consortium obtained a DOJ opinion release indicating that the DOJ would take no further action regarding the pre-acquisition conduct of the transacted entities.[23] However, Vetco subsidiaries continued to bribe Nigerian officials until April 2005, leading to a new round of DOJ enforcement that resulted in three Vetco entities pleading guilty to FCPA violations and paying $26 million in fines.[24] In its press release, the DOJ noted that Vetco International had voluntarily disclosed its post-acquisition violations and agreed to take further remedial steps, such as hiring an

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19. *Id.*

20. *See Former Pacific Consolidated Industries LP Executive Pleads Guilty in Connection with Bribes Paid to U.K. Ministry of Defense Official*, DEPARTMENT OF JUSTICE (Sept. 3, 2009), http://www.justice.gov/opa/pr/2009/September/09-crm-928.html ("In 2003, after the conduct alleged in court documents occurred, PCI was acquired by a group of investors . . . . PCI LLC referred the matter to the Department of Justice and cooperated in the government's investigation.").

21. *See id.; see also Private Investors Enter the FCPA Arena*, WILSON SONSINI GOODRICH & ROSATI (Jun. 27, 2007), http://www.wsgr.com/publications/pdfsearch/clientalert_fcpa2.pdf. Smith was eventually sentenced to six months in prison followed by six months home confinement. Richard L. Cassin, *Smith Sentence: Age, Health, and Time Served?* THE FCPA BLOG (Jan. 7, 2011), http://www.fcpablog.com/blog/2011/1/7/smith-sentence-age-health-and-time-served.html.

22. Complaint at 1–2, United States v. Vetco Gray Controls Inc., No. 07-CR-004 (S.D. Tex. Jan. 5, 2007), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/vetco-controls/02-06-07vetcogray-info.pdf; *see also ABB Closes Sale of Upstream Oil, Gas and Petrochemicals Business for $925 Million*, ABB (Jul. 12, 2004), http://www.abb.us/cawp/seitp202/3aa1ad328842deb7c1256ecf00524f4e.aspx.

23. *Foreign Corrupt Practices Act Review Opinion Procedure Release No. 2004-02*, DEPARTMENT OF JUSTICE (Jul. 12, 2004), http://www.justice.gov/criminal/fraud/fcpa/opinion/2004/0402.pdf; *see also* Robert S. Bennett et al., *Recent DOJ and SEC Settlements Illustrate the Importance of Anti-Corruption Compliance in the Context of Acquisition Transactions*, THE M&A LAWYER (Mar. 2007), http://www.skadden.com/sites/default/files/publications/Publications1243_0.pdf.

24. *Three Vetco International Ltd. Subsidiaries Plead Guilty to Foreign Bribery and Agree to Pay $26 Million in Criminal Fines*, DEPARTMENT OF JUSTICE (Feb. 6, 2007), http://www.justice.gov/opa/pr/2007/February/ 07_crm_075.html.

independent monitor to oversee a compliance program.[25] Given that (1) Vetco disclosed voluntarily, and (2) the case arose shortly after the PE acquisition, it seems likely that PE management played a corrective role in bringing Vetco into FCPA compliance.

A third example of portfolio company FCPA liability—and, potentially, PE's corrective role—may be observable in the acquisition of medical-device maker Biomet in September 2007 by a PE consortium that included The Blackstone Group, Goldman Sachs Capital Partners, Kohlberg Kravis Roberts & Co., and TPG.[26] According to a March 2012 SEC complaint, Biomet bribed doctors in Argentina, Brazil and China from 2000 to August 2008.[27] On the same day the SEC filed its complaint, Biomet settled with the DOJ for a criminal fine of $17.3 million and $5.5 million in disgorgement of profits and pre-judgment interest to the SEC.[28] The precise role, if any, of the PE consortium in addressing Biomet's FCPA violations is not clear, but from the timing of the violations' cessation shortly after the acquisition—and the fact that the PE investors avoided mention by the DOJ and SEC[29]—it seems likely that the government was satisfied the PE investors' role had been an ameliorative one.

In other cases, self-reporting by PE-owned operating companies have resulted in investigations that have concluded no wrongdoing occurred.[30] For example, in October 2010 Sensata Technologies—a sensor and control manufacturer majority-owned by affiliates of Bain Capital Partners LLC—disclosed in a 10-Q filing that it had conducted an internal investigation into possible FCPA violations by a subsidiary in China, and was further beginning "the process of making a voluntary disclosure of the possible

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25. *Id.*

26. Richard L. Cassin, *Biomet Pays $22.8 Million To Settle Bribe Charges*, THE FCPA BLOG (Mar. 26, 2012), http://www.fcpablog.com/blog/2012/3/26/biomet-pays-228-million-to-settle-bribe-charges.html.

27. *Third Medical Device Company Resolves Foreign Corrupt Practices Act Investigation*, DEPARTMENT OF JUSTICE (Mar. 26, 2012), http://www.justice.gov/opa/pr/2012/March/12-crm-373.html; *SEC Charges Medical Device Company Biomet with Foreign Bribery*, SECURITIES AND EXCHANGE COMMISSION (Mar. 26, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171487958#.U4UP8K1dWKw (announcing Biomet agreed to pay "more than $22 million" to settle the SEC's and DOJ's charges).

28. Cassin, *supra* note 12.

29. Dan Primack, *Biomet Busted for Bribery*, CNNMONEY, (Mar. 26, 2012), http://finance.fortune.cnn.com/2012/03/26/biomet-busted-for-bribery/ (reporting that missing from Biomet's settlement "was any mention of Biomet's private equity owners").

30. *See, e.g.*, *infra* note 31 and accompanying text.

violations, the investigation, and the initial findings" to the SEC and DOJ.[31] Seven quarters later, Sensata reported the DOJ had closed its inquiry.[32]

Along similar lines, Kosmos Energy Ltd.—acquired by The Blackstone Group and Warburg Pincus in 2008[33]—noted two FCPA issues in a 2011 S-1 registration filing.[34] First, Kosmos' S-1 reported that in January 2009 the DOJ "was notified" of a possible FCPA violation related to its oilfields off the coast of Ghana.[35] However, the S-1 further specified that "our outside FCPA counsel undertook a thorough investigation and found no basis for such allegations," and that in June 2010 the DOJ indicated it did "not intend to take any enforcement action and [had] closed their inquiry into this matter."[36] Second, the S-1 indicated that Modec, a Kosmos contractor, was being investigated by some of its partners and lenders regarding its own possible FCPA violations[37]—but an investigation by Modec's outside counsel revealed no violation, and no further action followed.[38]

Expro International offers yet another example of self-reporting. Expro—an oilfield management firm bought in 2008 by a PE consortium consisting of Goldman Sachs, Candover, and AlpInvest[39]—received a 2012

31. Sensata Techs. Holding N.V., Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2010 (Form 10-Q), at 26–27 (Oct. 22, 2010), *available at* http://www.sec.gov/Archives/edgar/data/1477294/000119312510234563/d10q.htm (noting Sensata "believes the amount of payments and the business involved was immaterial"); Joe Palazzolo, *Sensata Technologies Self-Discloses Possible Foreign Bribery Violations*, THE WALL STREET JOURNAL (Oct. 25, 2010), http://blogs.wsj.com/corruption-currents/2010/10/25/sensata-technologies-self-discloses-possible-foreign-bribery-violations/.

32. Sensata Techs. Holding N.V., Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2012 (Form 10-Q), at 19 (July 27, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1477294/000147729412000030/st-6302012x10q.htm; *see also* Christopher M. Matthews, *DOJ Closes Sensata FCPA Inquiry*, THE WALL STREET JOURNAL (Jul. 30, 2012), http://blogs.wsj.com/corruption-currents/2012/07/30/doj-closes-sensata-fcpa-inquiry/.

33. *Kosmos Energy Announces $500 Million Equity Funding*, BLACKSTONE (Jun. 19, 2008), http://www.blackstone.com/news-views/press-releases/details/kosmos-energy-annouces-$500-million-equity-funding.

34. Kosmos Energy Ltd., Registration Statement Under the Securities Act of 1933 (Form S-1) (Jan. 13, 2011) *available at* http://www.sec.gov/Archives/edgar/data/1509991/000104746911000139/a2200598zs-1.htm.

35. *Id.* at 35.

36. *Id.*

37. *Id.*

38. Samuel Rubenfeld, *Modec Finds No FCPA Violations at Ghana Oilfield*, THE WALL STREET JOURNAL (Jan. 24, 2011), http://online.wsj.com/news/articles/SB10001424052748703555804576102662462716084.

39. *See*, *e.g.*, Ben Casselman, *Halliburton Pulls Bid for U.K.'s Expro*, THE WALL STREET

email from an anonymous whistle-blower alleging that Expro had paid bribes to customs officials in Kazakhstan from 2006 until summer 2009.[40] After *The Wall Street Journal* obtained access to one or more such emails, an Expro spokesperson told the newspaper that the company had previously notified authorities in the U.S. and Britain of the whistle-blower's allegations and had conducted an internal review which did not uncover "any issues of concern."[41] To date, the anonymous whistle-blower's claims have not led to any further investigation or enforcement action.

One possible counterexample to these instances of self-reporting may be found in Manroland AG, a German printing equipment maker that is 60 percent owned by Allianz Capital Partners, the PE arm of European insurer Allianz SE.[42] In 2010 the SEC opened an investigation into a subsidiary of Manroland that may have paid bribes "in Europe and elsewhere,"[43] but the SEC later declined to pursue charges, reportedly in part because of "German ownership laws that make it difficult to obtain information[.]"[44]

Finally, there are likely ongoing government investigations into the dealings of a number of investment firms (including PE firms) with sovereign wealth funds (SWFs), but these investigations remain shrouded in secrecy, with press reports typically citing unnamed sources.[45] News reports in January 2011 indicated that up to ten investment banks and private equity firms had received letters from the SEC asking about their interaction with SWFs and requesting that the investment firms retain related documents.[46] In February 2014 it further emerged that the DOJ had joined an SEC probe into western firms' efforts to engage Libya's government run investment fund.[47] The outcome of these investigations remains unknown.

JOURNAL (Jun. 23, 2008), http://online.wsj.com/news/articles/SB121400433820193459.

40. *See*, *e.g*., Christopher M. Matthews, *Expro Re-Investigates Bribery Allegations*, THE WALL STREET JOURNAL (Aug. 15, 2012), http://blogs.wsj.com/corruption-currents/2012/08/15/expro-re-investigates-bribery-allegations/.

41. *Id*.

42. Riella & Shepherd, *supra* note 7.

43. *U.S. SEC to Limit Charges Against Allianz*, REUTERS (Oct. 14, 2011), http://www.reuters.com/article/2011/10/14/allianz-fcpa-idUSN1E79D1DY20111014 (citing unnamed sources presumably within the SEC).

44. *Id*.

45. *See, e.g*., *infra* note 46 and accompanying text.

46. Dionne Searcey & Randall Smith, *SEC Probes Banks, Buyout Shops Over Dealings With Sovereign Funds*, THE WALL STREET JOURNAL (Jan. 14, 2011), http://online.wsj.com/news/articles/SB10001424052748704307404576080403625366100.

47. Joe Palazzolo, *Probe Widens Into Dealings Between Finance Firms, Libya*, THE WALL

III. ANALYSIS: WHY NO PROSECUTION OF PE FIRMS TO DATE?

As the foregoing suggests, the most straightforward explanation for PE's avoidance of FCPA prosecution is that PE firms are mindful of the FCPA and are employing appropriate mechanisms—such as pre-deal due diligence and post-deal control and audit mechanisms, coupled with voluntary self-reporting when necessary—to ensure compliance with the law. Indeed, in the FCPA context, deal-making itself probably plays a kind of disinfectant role. Pre-deal due diligence—motivated by an investor's natural financial incentive to ensure all existent liabilities are reflected in the price paid—will tend to expose FCPA violations or risky practices. This remedial effect can be expected to continue post-deal, given that the PE model dictates intensive study of the acquired company by its new owners as they seek to improve the company in anticipation of an eventual exit. This effect will be amplified if, in the months after a new acquisition, an investor enjoys a regulatory grace period during which it can report newly-discovered problems while facing limited culpability.

A second possible reason for the lack of FCPA prosecutions is that infractions by companies currently owned wholly or in part by PE firms might remain hidden from PE firm executives. Although less likely than in the past given the heightened level of scrutiny being applied to new investments, it is conceivable that questionable behaviors escape detection during the due diligence process and continue once the violating firm enters the PE firm's portfolio. Alternatively, even if the company is clean at the time of investment, violations can begin after investment by the PE firm and remain hidden, a scenario made plausible by the masking effect of rapid growth. Finally, even if difficulties are discovered internally, portfolio company managers have significant incentives to conceal knowledge of infractions, even from their PE investors.[48]

A third reason may be under-reporting by PE firms. PE firms who are aware of suspicious circumstances in portfolio companies might choose to rectify rather than report in the belief that the infraction is isolated, non-systemic, or already nearly remedied and thus no longer relevant. PE firms

STREET JOURNAL (Feb. 3, 2014), http://online.wsj.com/news/articles/SB10001424052702303743604579355162160100456?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702303743604579355162160100456.html.

48. *See, e.g.*, Rick Carew, *How a Sweet Deal in China Turned Sour*, THE WALL STREET JOURNAL (Nov. 17, 2008), http://www.wsj.com/articles/SB122688094074832033.

might also decide to under-report because the portfolio company in question is about to exit the PE firm's portfolio, thereby enabling the PE firm to offload the problem and attendant risk to the new buyer who might regard the infraction as minor or who, in the case of some foreign buyers, might not even need to comply with the FCPA.

Finally, a fourth reason for the lack of FCPA prosecutions may be that PE firms are refraining from investments in countries that suffer from high levels of corruption. According to a 2011 Deloitte survey of North American corporate executives, 53% of financial buyers (and 79% of strategic buyers) "identified FCPA and anti-corruption issues that led to an aborted deal or a renegotiation."[49] A November 2013 AlixParners survey of *global* senior executives found corruption worries less widespread but still significant: 30% of respondents had ceased doing business with certain partners because of concerns related to corruption, and 15% of respondents' companies had "pulled out of acquisition deals because of possible corruption at the target.[50] Concern tends to focus on emerging markets: the AlixPartners survey found that "Africa was perceived to be the riskiest place [globally] to do business: 56% of participants said doing business there posed significant risk. Russia came next, at 53%, followed by the Middle East at 49%, Central and South America at 48%, Mexico at 48%, and Southeast Asia at 46%."[51] According to a second AlixPartners survey, a quarter of all respondents "avoided or ceased doing business [in Africa] because of concerns about their ability to comply with anticorruption laws," and "[e]ighty-six percent of those whose companies operate in Africa said they faced some risk associated with corruption."[52]

49. DELOITTE, LOOK BEFORE YOU LEAP: MANAGING RISK IN GLOBAL INVESTMENTS 7 (2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Content/Articles/Financial%20Advisory%20Services/us_fas_Look%20Before%20You%20Leap_012711.pdf.

50. ALIXPARTNERS, ALIXPARTNERS ANNUAL GLOBAL ANTI-CORRUPTION SURVEY 1-2 (2014), *available at* http://www.alixpartners.com/en/LinkClick.aspx?fileticket=D6cmPtMQahg%3d&tabid=635 (reporting results of a survey of "general counsel, compliance officers, and other senior executives . . . at companies based in North America, Europe, the Middle East, and Asia that have annual revenues of $150 million or more").

51. *Id.* at 1.

52. ALIX PARTNERS & DENTONS, AFRICA: NOW OPEN FOR BUSINESS 6 (2013), *available at* http://www.dentons.com/~/media/PDFs/Insights/2013/April/Africa_Open_for_Business.ashx (reporting results from a "survey group . . . comprised of chief operating officers, general counsel, and other senior executives who are responsible for legal, compliance, and corporate business development . . . primarily from U.S. companies with annual revenues of $250 million or more (more than a third had revenues of $10 billion or more)").

This substantial corruption concern suggests that PE firms may be conceding opportunities to FCPA-exempt investors who have less interest in cleaning up troubled companies or improving corporate standards: for example, the extensive and growing presence of Chinese firms—often SOEs—in Africa.[53] However, if the pattern we have observed—that PE deal-making and FCPA amelioration go together—is a real one, then PE investment in regions struggling with corruption should actually further the anti-corruption aims of the FCPA. Thus, FCPA enforcement, brutally applied, may have the unintended effect of forestalling opportunities for reform.

IV. LINKING ENFORCEMENT AND INTERVENTION

A possible solution to the problem of PE firms foregoing investment due to FCPA risk is for the DOJ and SEC to collaborate with investors on a case-by-case basis, essentially licensing temporary, imperfect compliance for newly acquired companies if those companies can demonstrate they are engaged in substantive remedial efforts.[54] Something of this kind can be observed in the DOJ's willingness to weigh in on potential acquisitions, such as in the acquisition of Vetco by a PE consortium consisting of Candover, 3i and JP Morgan Partners. In that case, the DOJ provided a pre-acquisition opinion release letter indicating that the DOJ would take no further action regarding the pre-acquisition conduct of the transacted entities.[55]

More ambitiously, in its hostile bid for British oilfield services firm Expro, Halliburton was able to gain a DOJ release from liability for limited

53. According to one tally, Chinese outward investment 2005–2012 in Sub-Saharan Africa totaled $97.8 billion. DEREK SCISSORS, THE HERITAGE FOUNDATION, CHINA'S GLOBAL INVESTMENT RISES: THE U.S. SHOULD FOCUS ON COMPETITION 3 (2013), *available at* http://thf_media.s3.amazonaws.com/2013/pdf/bg2757.pdf. In comparison, total U.S. FDI in China in 2012 was $61.381 billion. *U.S. Direct Investment Abroad: Balance of Payments and Direct Investment Position Data*, U.S. DEPARTMENT OF COMMERCE BUREAU OF ECONOMIC ANALYSIS, http://www.bea.gov/international/di1usdbal.htm (last modified Dec. 17, 2014). PE firms invested $631 million, $1.059 billion, and $1.162 billion in Sub-Saharan Africa in 2010, 2011, and 2012, respectively. *2012 EM PE Annual Fundraising and Investment Review*, *supra* note 8, at 6.

54. *See* Adam Prestidge, *Avoiding FCPA Surprises: Safe Harbor From Successor Liability in Cross-Border Mergers and Acquisitions*, 55 WM. & MARY L. REV. 305, 326–29 (2013) (urging the addition to the FCPA of a safe harbor provision for both pre- and post-acquisition violations).

55. *Foreign Corrupt Practices Act Review Opinion Procedure Release No. 2004-02*, DEPARTMENT OF JUSTICE (July 12, 2004), http://www.justice.gov/criminal/fraud/fcpa/opinion/2004/0402.pdf.

post-acquisition misconduct by Expro.[56] Halliburton argued that, because of restrictions imposed by the U.K. Takeover Code, it could not sufficiently engage in due diligence or "insist upon remedial measures until after the acquisition [was] completed."[57] Instead, Halliburton proposed a robust post-acquisition remedial effort coupled with ample, ongoing disclosure to the DOJ.[58] The DOJ approved Halliburton's plan, stating in Opinion Release 08-02 that it did not

> intend to take any enforcement action against Halliburton for . . . any post-acquisition conduct by Target disclosed to the Department within 180 days of the closing, and which does not continue beyond the 180-day period or, if in the judgment of the Department the alleged conduct cannot be fully investigated within the 180-day period, which does not continue beyond such time as the conduct can reasonably be stopped.[59]

While 08-02's approach was described as groundbreaking at the time,[60] the DOJ was careful to tailor its letter narrowly to the particular circumstances of Halliburton's proposed acquisition, and the DOJ did not issue any similar dispensation for four years; however, in 2012, the DOJ and SEC jointly released an FCPA resource guide that endorsed the approach taken in 08-02, specifying that, "where adequate pre-acquisition due diligence is not possible," an acquirer may "follow the measures set forth in Opinion Procedure Release No 08-02, or seek their own opinions."[61] Our review of PE investment and its effects on FCPA compliance suggests this kind of regulatory flexibility promises only to amplify the FCPA's goals while diminishing its tendency to forestall otherwise promising investments.

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56. *Foreign Corrupt Practices Act Review Opinion Procedure Release No. 2008-02*, DEPARTMENT OF JUSTICE (June 13, 2008), http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0802.pdf.

57. *Id.*

58. *Id.*

59. *Id.*

60. Andrew M. Baker et al., *DOJ Releases Groundbreaking FCPA Opinion*, BAKER BOTTS (June 23, 2008), *quoted in* Prestidge, *supra* note 54, at 320.

61. DEPARTMENT OF JUSTICE & SECURITIES & EXCHANGE COMMISSION, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 32 (2012), *available at* http://www.justice.gov/criminal/fraud/fcpa/guidance/guide.pdf.

V. CONCLUSION AND FUTURE RESEARCH

Our analysis demonstrates that PE firms have yet to be prosecuted by the DOJ or SEC for direct FCPA violations within their own investment operations, even as some PE firms have received scrutiny because of the infractions of their portfolio companies. We believe that the DOJ and SEC will become increasingly active in policing PE firms because of the unique role of PE firms in emerging markets, which present substantial compliance risk. Given that global investment activity and enforcement efforts are growing and appear to be on a collision course, it is simply a matter of time before PE firms face more prosecution.

In terms of new investments, PE firms appear to have recognized the importance of ensuring that their investment operations conform with FCPA requirements, and PE firms now routinely include FCPA infraction assessment as part of due diligence associated with new investment decisions. Although originally implemented to defend against the threat of FCPA enforcement, this type of assessment has evolved into a useful prophylactic, helping PE firms identify procedural weaknesses and corruption risks in the business models of investment candidate companies. Additionally, the resulting, detailed view of risk is enabling PE firms to determine if remedies such as process improvements, personnel changes, or new governance models are likely to be feasible and sustainable in the investment being contemplated.

In tainted companies where remediation appears doubtful either because of inadequate supervisory capabilities on the part of the PE firm or because of recalcitrant investee company managers, PE firms typically withdraw from the deal[62]—perhaps more often now than in the past, although good data remains scant. Depending on the case, withdrawal might prove prudent for the PE firm, but does raise concerns of a macro nature; notably, whether the threat of FCPA prosecution could reduce the number of investment candidates considered investment-worthy by PE firms, and thereby open the door to competitors of American firms who might not only perpetuate bad corporate governance practices following investment but also forestall broader reform. In practice, this concern might apply only to marginal environments with the highest risk level and represent only a small number of so-called missed opportunities—although more work needs to be

62. DELOITTE, *supra* note 49, at 1, 13 (2011).

done to discern the true scale of this ironic, unintended consequence.

When we look at the existing investments of PE firms, it is more difficult to determine the degree of compliance with the FCPA across investments already inside a PE firm's portfolio. Many current portfolio companies received funds in the period before the recession of 2008[63]—before the DOJ and SEC ramped up FCPA enforcement—and thus ahead of FCPA-oriented new investment due diligence of the kind described above. While most PE firms wish to drive consistent application of FCPA compliance standards not only to ensure lawful behavior by their firms, but also to instill consistency and simplicity in their operations, it is certainly reasonable to conclude that some FCPA risk might continue to exist inside vintage investments. Where risks are known, the PE firms have shown that they are generally willing and capable of correcting the source of the violation and can play an important role in executing and supervising change.

It is increasingly evident that the DOJ and SEC not only expect PE firms to be compliant with regard to new investments but instrumental in compelling compliance by their portfolio firms. Indeed, PE firms should expect regulators to increasingly emphasize a comprehensive, zero-tolerance approach for both new investment candidates and existing portfolio companies. While this logical evolutionary step in enforcement might sound burdensome to PE firms, it could also form the basis of a more symbiotic relationship between regulators and PE firms, and it might lead to the development of a formal advance-clearance program, which could prove useful to both parties. For example, such a program would enable PE firms to declare FCPA infractions, propose corrective actions and governance reforms that are approved by the DOJ, and then implement lasting change to the company under discussion—rather than simply abandoning the company or the deal. In so doing, the DOJ would make full use of the unique ability of PE firms to enact and supervise changes within violating companies. American shareholders would benefit from the combination of legal protection proffered by FCPA and the authorized corrective actions of PE firms working in concert with the DOJ and SEC to expand good governance practices worldwide.

Given that PE firms have thus far avoided prosecution—and

63. *See Private Equity Industry Overview*, STREET OF WALLS (2013), http://www.streetofwalls.com/finance-training-courses/private-equity-training/private-equity-industry-overview/.

corporations have not—corporations seeking to invest in emerging markets might consider whether they are up to the extensive task of FCPA diligence in new acquisitions and investments, as well as the extensive remediation that might be required by post-acquisition. An alternative for corporations might be to buy companies that have already been remade and cleansed by the PE firms. This might save both time and money for corporate actors, while also reducing risk and uncertainty for their shareholders.

This essay highlighted the implicit cooperation between PE and regulators that is increasingly evident in practice and argued for more collaboration in the future. In designing possible mechanisms for enhanced collaboration, more work needs to be done to address the following issues: How might a more explicit case-by-case review and remediation process yield more effective outcomes? How would the DOJ and SEC benefit from such a program? What costs will PE firms need to bear? How will PE firms benefit from participation? Should participation by PE firms be mandatory? Will PE firms agree to see their fund serve as an instrument of U.S. regulation? What metrics should be adopted in order to gauge performance and impact? Answering these issues and developing a plausible design for cooperation will better define the full potential of the unique relationship now developing between U.S. regulators and U.S. PE firms operating in emerging markets.

In high-risk foreign markets, it is conceivable that a cooperative approach built around specialization—rather than an adversarial approach, which might otherwise become the default—could yield the most efficient outcomes for all parties. The DOJ and SEC could direct enforcement and guide reform by appropriately demanding compliance from US entities, as required by the FCPA, but also by co-opting the capabilities of PE firms already operating in such investment zones. PE firms could invest in high-risk, high-reward emerging markets, confident that the FCPA risks could be vetted and ameliorated over time with the understanding of regulatory authorities. Strategic buyers, if they choose to use the new ecosystem, could acquire companies already sanitized and thus less likely to generate negative news and unwanted reverberations in share price. Finally, American investors in either PE firms or US corporations could find a more robust system that achieves both enforcement and remediation while leaving investors better protected from consequences of corruption in foreign markets.

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