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Global Issues: Compliance – Service Providers

Investigators: Compliance, M&A, JV, Due Diligence And More

The Editor interviews Scott Shaffer, Vice President of Sales, Kreller Group.

Editor: Describe your activity and the services it provides to global companies? Describe your staff?

Shaffer: The Kreller Group, Inc. specializes in providing due diligence and background investigations worldwide on corporations and individuals. We also conduct international credit queries and assist companies with collection efforts. Specifically, my current responsibilities include: proactive consulting with existing clients to address due diligence objectives, customizing due diligence programs for new customers, analyzing current

Scott Shaffer is the Vice President of Sales for the Kreller Group in Cincinnati, Ohio, where he manages due diligence investigations on an international scale. His current responsibilities include: proactive consulting with existing clients to address due diligence objectives, customizing due diligence programs for new customers, analyzing current trends regarding regulatory compliance, and working closely with domestic and international investigators to keep current on security issues. Scott works with many Fortune 500 companies, including those in the Financial, Energy, Petroleum, Defense, Telecommunications, and Franchising sectors. Prior to his current role, Scott was an International Trade Consultant with the Kreller Group where his focus was on providing U.S.-based corporations credit and collection services on foreign companies. Scott is a graduate of Miami University in Oxford, Ohio and has been a featured speaker at several conferences in regards to international risk. He is a member of the Overseas Security Advisory Council (OSAC), the American Society of Industrial Security (ASIS), the Energy Security Council (ESC), and the International Franchise Association (IFA).

trends regarding regulatory compliance, and working closely with domestic and international investigators to keep current on security issues. Kreller's staff is comprised of a team of licensed investigators and analysts with experience in federal, state and local law enforcement and case managers who interact with clients to determine due diligence objectives. In addition, we utilize an exceptional network of global contacts and resources to assist with international groundwork.

Editor: How should in-house counsel select an outside investigative firm? How can costs be kept in line?

Shaffer: In light of recent situations involving corporations using unprofessional investigators, in-house counsel should be very careful in selecting an outside firm to assist. The first step would be to identify the situations in which outside agencies would be utilized and find firms that can assist with your particular research. Professional associations, colleagues, and associates may provide a recommendation or referral. Second, verify the company is licensed with no instance of improper or unethical investigations in the past. Third, obtain references and speak directly with current clients. Finally, have the firm sign a non-disclosure agreement, discuss price, turn time, contractual obligations, and expectations of investigations.

As for costs, I can only speak for our system of pricing; many investigative firms handle this differently than we do. Before an investigator is hired to assist with research, they should be given a clear understanding of the objectives of the work to be performed. How many companies? Where are they located? Are there individuals involved? If so, how many? Do they have affiliates or subsidiaries? If so, where are they? After the breadth of the investigation is understood, we prefer to give a cost and delivery time esti-

mate based on our experience of the time and resources required to complete the project. However, through the course of an investigation, we may uncover additional areas of research that may be of use to the client. We then discuss it with the client and make a determination whether to proceed.

Editor: What types of relationships require third party due diligence?

Shaffer: Strategic Partnerships, Joint Ventures, Mergers and Acquisitions, Vendors, Customer Acquisition, Distributors, Upper Management Positions, Sales Agents/Consultants and License and Franchise Agreements.

Editor: Describe the scope of the FCPA and U.S. Export Controls? What are the penalties?

Shaffer: The Foreign Corrupt Practices Act ("FCPA") was passed by Congress in 1977 after federal investigations in the mid-1970s discovered over \$300 million in suspect or outright illegal payments made by hundreds of American businesses to foreign officials to influence favorable business decisions. Designed to ensure that American companies conduct international business ethically, the FCPA is jointly enforced by the Department of Justice and the Securities and Exchange Commission. It consists of two parts: anti-bribery provisions and accounting provisions. Violations of FCPA carry both criminal and civil liabilities resulting in steep fines and imprisonment. Business entities are subject to initial fines of up to \$2 million while individual officers, directors, stockholders, employees, and agents may be fined up to \$100,000 and imprisoned up to five years for criminal violations of the anti-bribery provisions. Actual fines may be much higher according to the Alternative Fines Act. Persons or firms violating the FCPA may still be subject to

Please email the interviewee at sshaffer@kreller.com with questions about this interview.

other governmental actions, including the suspension of government procurement rights (for indictment alone) and suspension or refusal of export license, which can close the door for many businesses. Not only is government enforcement of the FCPA increasing (a record 29 investigations of FCPA violations and 16 federal enforcement actions last year) but also more laws are being created and enforced to aggressively attack fraud, corruption, and bribery. The Patriot Act was designed to prevent the financing of terrorism and money laundering by foreign and domestic criminals. Sarbanes-Oxley is forcing companies to ferret out fraud. Several other countries have adopted similar policies, largely resulting from global anticorruption initiatives from the Organization for Economic Cooperation and Development (OECD)

Editor: We have talked about sanctions. What other harms may befall an organization besides financial loss?

Shaffer: Companies may lose their export license and/or government procurement rights, as well as experience adverse publicity, loss of shareholder confidence, weakened corporate integrity and damaged customer confidence. Individuals directly involved may face imprisonment.

Editor: In connection with M&A transactions and joint ventures, to what extent can you provide information about the other party and the individuals involved? Do you assist in due diligence? What protective steps do you recommend? Do strict privacy laws affect your activities in some countries? Examples?

Shaffer: In a typical JV or M&A transaction, we research the company and principals as desired by client. Principals may include, but are not limited to, beneficial owners, senior management and other key individuals. Our investigation would include: corporate record research, media review, criminal/civil checks, business/partnership affiliation, discussion with regulatory agencies, reference/employment/education verification, and an exhaustive review of Denied Party Lists. If possible, I would recommend a thorough questionnaire and authorized consent to be completed by the subject and any individual of potential interest to adhere to various privacy laws globally. Privacy Laws, even with authorized consents, limit our ability to access or obtain certain information. For instance, the Data Protection Act, which impacts the United Kingdom and most of the European Union, forbids formal criminal queries. These privacy laws are becoming more commonplace both in the U.S. and internationally and will most likely continue to increase.

Editor: Describe the dynamic between investigator and in-house counsel.

Shaffer: The process of performing an investigation begins with a consultant (case manager) acquiring information on the subject and developing an understanding of specific objectives and concerns for the case at hand. This information and understanding is then passed on to the investigative team where a lead investigator assumes control of the process. The lead investigator disseminates the information to appropriate agents and contacts with the region and country of focus and the investigation is started. During the investigation, it is essential that the client and case manager maintain communication channels. As the investigator begins "digging up" business intelligence, the ultimate objectives of the investigation may change and additional work may or may not be needed. Due to their complexity and sensitivity, some investigations require the "do whatever it takes" approach. But, not every situation warrants tens of thousands of dollars to be spent on obtaining background information. More often than not, clients have specific issues that can be addressed while keeping costs controlled. For the process to succeed, the company and outside investigator must focus on the goal of the research, which is to produce a precise evaluation of the legal and commercial risks posed by an association with a third party.

Editor: What are the advantages in utilizing an outside investigative agency?

Shaffer: For clarification, outside investigative agencies should not replace your own internal due diligence efforts. Firms should be utilized to supplement and increase the amount of information you have on which to base your business decision. Investigative agencies offer an unbiased review of the potential target and should bring to light any derogatory information. They may have experience and expertise in a region of the world where you may feel inadequate with your own capabilities. Experience has demonstrated that time and money invested in due diligence investigations has saved many corporations from financial disaster and irrevocable reputation embarrassment.

Editor: Can you provide recent examples in which derogatory or deal-breaking information was found? How do you separate fact from fiction?

Shaffer: A business development manager of a major U.S. energy concern located a sales agent in the Middle East who promised he could deliver on government contracts. Before engaging him, the development man-

ager reviewed the terms with the legal/compliance department. They in turn asked the development manager to have the sales agent complete an application and authorization, in which he agreed that he understood the FCPA and had no ties to government officials. Through the course of our investigation, it was found the sales agent was a PEP (Politically Exposed Person) due to his father's high-level position with the local government.

A large U.S.-based manufacturing company was planning to acquire a smaller competitor in South America. Before the accounting firms and attorneys were involved, the general counsel requested a due diligence to be performed on the target company and select senior level executives. It was found that the primary owner of the subject was currently involved with three additional companies, two of which filed bankruptcy and the other was listed as "dormant." Further research showed the company to have several recent civil filings for large amounts due to contractual issues, which in turn brought into question the financial solvency of this company.

Separating fact from fiction is difficult, especially in foreign jurisdictions where accessibility of database records is minimal. Investigators must focus on the facts and try to separate those from rumors, biased media reports or politically motivated negativity. If possible, investigators should attempt to verify the information from various sources, or at least provide a credible explanation as to the accuracy of the source.

Editor: What are some of the potential "red flags" which companies should be on the alert for?

Shaffer: If any of the following situations are found, ask direct questions of the applicant. There may be a suitable explanation, especially when dealing in foreign locales. However, what may seem like a minor detail or omission can lead to a trail of deceit and corruption:

- Failure of applicant to provide basic documents;
- Address provided is determined to be a mail drop;
- Prior judgments, liens, or bankruptcies;
- Non-disclosure of civil/criminal litigation;
- Criminal arrests;
- Failure to verify provided information;
- Failure to confirm references;
- Applicant becomes argumentative over basic requests for information;
- History of corruption in country (Transparency International); and
- Family relationship between participants and government officials.