WEIL GOTSHAL

Private Equity Alert

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Weil News

- Weil Gotshal won Private Equity Team of the Year at the 2008 Legal Business Awards for the firm's involvement in advising Terra Firma on the $6.4 billion take private bid of EMI Group plc
- Chambers recommended seven of our European private equity partners in its 2008 Chambers Europe directory: Gerhard Schmidt in Frankfurt, Marco Compagnoni and Mark Soundy in London, David Aknin, Frederic Cazals and Emmanuelle Henry in Paris and David Dederick in Central & Eastern Europe
- Weil Gotshal advised Thomas H Lee Partners in connection with the acquisition of approximately 63% of the equity securities of MoneyGram International, Inc. by affiliates of Thomas H Lee Partners and Goldman Sachs & Co.
- Weil Gotshal advised Capital Z Investment Partners in connection with a management buyout of its hedge fund sponsorship business
- Weil Gotshal advised Union Square Partners in connection with its investment in MountainView Capital Holdings, LLC, a specialty financial services company
- Weil Gotshal advised American Capital Strategies in connection with its sale of Exstream Software, LLC to Hewlett-Packard Co.
- Weil Gotshal advised American Capital Strategies in connection with its sales of Ranpak Inc. to Odyssey Investment Partners
- Weil Gotshal advised Genstar Capital, LLC in connection with its acquisition of TravelClick Holdings, Inc.

Ignorance of the FCPA is No Excuse

By Chip Roh (chip.roh@weil.com), Joe Tortorici (joe.tortorici@weil.com) and Joseph Johnson (joseph.johnson@weil.com)

Private equity sponsors and hedge funds are increasingly investing in emerging markets, including through dedicated investment funds. The risk of corrupt payments is higher in those markets than in most developed markets and U.S. investors are subject to the U.S. Foreign Corrupt Practices Act (FCPA) in connection with those investments. Recently, the U.S. government has become more aggressive in enforcing the FCPA. In addition, as evidenced by the ongoing Siemens inquiry, European governments have also become more aggressive in pursuing FCPA-style corruption investigations. Private equity sponsors and hedge funds investing outside the U.S., especially those that invest in emerging markets, should be proactive in ensuring that they and their representatives take appropriate actions in connection with those investments to avoid or reduce the risk of civil or even criminal liability under the FCPA.

The FCPA

The FCPA prohibits bribery of foreign government officials, candidates for office and officials of political parties. It is framed and interpreted very broadly to prohibit not just actual direct bribes, but virtually any way a company might directly or through agents or joint ventures improperly influence foreign government officials, candidates for office and political parties. The FCPA applies not only to U.S. nationals and to companies organized under US laws (wherever the individuals or companies are located), but also to foreigners or foreign companies with a connection to the United States. Both the substantive law and its coverage are given a very broad interpretation, well beyond what is customary for most non-Americans. Paying for entertainment or arranging a cushy job for a current or former government official or his or her relative could all be considered a bribe.

Private equity sponsors and hedge funds can have a problem under the FCPA even if the bribery occurred prior to their acquisition and not on their watch. A U.S. private equity or hedge fund that buys a foreign company that has been violating the FCPA not only inherits the liability of that company for its past actions, but may find that the fund itself is liable for ignoring the ongoing nature of the bribes, even if there is no evidence that the fund or its officers directly knew of the bribery. The potential liability for public companies is still greater, since the mere fact of filing reports with the SEC is enough to make a company liable under the FCPA, and the issuers face additional responsibilities in terms of books and records controls.

The FCPA can also adversely affect exit opportunities for U.S. private equity sponsors and hedge funds regardless of whether the Department of Justice (DOJ) commences an investigation of bribery by a portfolio company or its agents. If a portfolio company or its agents has engaged in illegal or questionable behavior under the FCPA, that may make it difficult to take the company public in the U.S. or to sell the company to a U.S. public company or other buyer that performs rigorous FCPA diligence. The private equity sponsor or hedge fund may also have potential liability to the buyer under FCPA-specific or compliance with laws representations and warranties in the sale agreement.

Recent FCPA-Related Actions

Some recent FCPA enforcement actions illustrate the risks under the FCPA for private equity sponsors and hedge funds. In early 2007, the DOJ announced that three Vetco International Ltd. subsidiaries pled guilty to violating the anti-bribery provisions of the FCPA and had agreed to pay $26 million in fines and penalties. Vetco Gray UK Ltd., one of these three subsidiaries, had previously pled guilty in 2004 to related violations. Around that time, a group of private equity investors sought to acquire that company. In anticipation of the acquisition, those investors conducted an extensive compliance review and requested an opinion release from the DOJ. In response to this request, the DOJ issued an opinion indicating it did not intend to undertake actions against the acquirers or acquired company for violations that may have occurred prior to the acquisition. However, the opinion was premised on the institution of an extensive compliance program and indicated that it did not encompass prospective conduct. When the payment of various illegal bribes continued after the acquisition and until April 2005, the DOJ brought new enforcement actions, ultimately resulting in the 2007 guilty pleas and fines. In connection with these recent pleas, Vetco Gray UK Ltd. agreed to the appointment of an independent monitor, to undertake further investigations, and agreed to monitoring and compliance obligations that would bind any future purchaser.

Investors should not bury their head in the sand and ignore any potential problems or hope they go away.

Also in 2007, Omega Advisors agreed to pay $500,000 as a civil penalty as part of its non-prosecution agreement where it acknowledged that a fund officer had been aware, prior to the investment, that there was bribery involved in a transaction in which Omega invested, and that the officer had entered into these investments on behalf of Omega with the understanding that he was taking advantage of these arrangements. The DOJ indicated that it exercised leniency toward Omega because of Omega's past and continuing cooperation with the investigation, its implementation of remedial measures, including an FCPA compliance program, and the absence of prior similar conduct by Omega. The former Omega officer pled guilty to charges of conspiracy to violate and violation of the FCPA in 2004.

In a third example in 2007, Leo Winston Smith, a former executive vice president and director of sales and marketing for Pacific Consolidated Industries, was indicted for allegedly conspiring to provide bribe payments to an official in the U.K. Ministry of Defense for the purpose of obtaining contracts. Pacific Consolidated Industries was a privately-owned Californian company, which was acquired by Cherington Capital, a private equity group, in 2003, *after* the events that ultimately resulted in the 2007 indictment of Mr. Smith. Cherington, following completion of its purchase of Pacific Consolidated Industries, apparently discovered records of suspicious payments made to the Ministry of Defense during its post-acquisition audit. Pacific Consolidated Industries voluntarily referred this matter to the DOJ and fully cooperated in its subsequent investigation. It is not known whether Cherington Capital will incur any fines or penalties in connection with this FCPA violation.

There are dangers in trying to draw too many lessons from the very limited record available, but these examples demonstrate that private equity sponsors and hedge funds can have potential exposure under the FCPA even if they had no direct part in the alleged illegal conduct.

Dos and Don'ts for Investors

The cases referenced above illustrate only a few of the many ways FCPA issues may arise before or after a private equity sponsor or hedge fund completes an acquisition. Investors active in emerging markets need to make sure they are taking steps to ensure compliance with the FCPA, especially as an acquisition of a company does not necessarily eliminate exposure to past violations. Private equity sponsors and hedge funds should consider the following to avoid or reduce any potential liability under the FCPA:

- Do have an effective FCPA compliance program for your fund, including periodic training of employees to be sensitive to FCPA and related issues
- Do a thorough due diligence review of a potential acquisition target for potential FCPA violations, particularly where red flags are uncovered. Examples of red flags include a history of corruption in the

particular countries where the target company does business, weak or poorly enforced FCPA compliance policies by the target company, weak or non-transparent accounting policies, procedures and records in the target company, a failure by the target company to require compliance by its agents and consultants and business that is dependent on government customers or governmental regulatory approvals.

- Do consider voluntarily reporting any potential problems uncovered to the DOJ in connection with an investment if you decide to proceed with the investment or if you discover the potential problems after you made the investment.
- Do periodic FCPA compliance audits of portfolio companies after you make your investment.
- Don't ignore red flags, which may be as obvious as an investment opportunity that seems "too good to be true" due to superior access to or accommodations by government officials. Bribery may be one reason why that investment opportunity seems like such a sure bet and U.S. authorities may not be sympathetic to pleas by U.S. investors of lack of actual knowledge of the bribery. If a red flag is discovered, investors should carefully diligence the target company to identify any potential problems.
- Don't ignore potential problems discovered in due diligence and make the investment without resolving the problems. Trying to ignore or bury problems can be a time-bomb—whistleblower employees, former employees, competitors, foreign governments and auditors all can reveal bribes, and more than one FCPA violation has come to light as result of the diligence of buyers when an investor tries to re-sell its portfolio company or in connection with an IPO.

With the increasing investments by private equity sponsors and hedge funds in emerging markets, those investors need to proactively ensure that they and their representatives take appropriate actions in connection with those investments to avoid or reduce the risk of civil or even criminal liability under the FCPA. Investors should not bury their head in the sand and ignore any potential problems or hope they go away. No one wants to become the poster child for DOJ enforcement of FCPA violations by a private equity sponsor or hedge fund.

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PBGC Ruling Extends Control Group Liability to Private Equity Fund

By Andrew Gaines (andrew.gaines@weil.com)

A recent decision by the Appeals Board of the Pension Benefit Guaranty Corporation (PBGC) may have important implications for private equity funds. In its decision, the PBGC held that a private equity fund and its other portfolio companies were jointly and severally liable for the funding deficiency in a defined benefit pension plan sponsored by one of the portfolio companies. As such, the private equity fund was required to use its assets to fund the pension obligations of a bankrupt portfolio company.

Control group liability is not new or controversial. Under ERISA, a control group is generally a parent subsidiary group of trades or businesses in which the parent owns a controlling interest in the subsidiary. A controlling interest is defined in the case of a corporation as stock ownership by the parent of at least 80% of the total voting power of all classes of stock entitled to vote or at least 80% of the total value. Prior to this decision, many practitioners argued that a private equity fund should not be included in the same control group as their portfolio companies because a fund does not carry on a "trade or business" within the meaning of ERISA. In its decision, the PBGC found that the private equity fund was a "trade or business" and was, therefore, a member of the same controlled group as its 80% owned portfolio company. The decision by the PBGC is not surprising since it is the quasi governmental entity responsible for insuring participants and beneficiaries in situations when a pension plan is terminated with insufficient assets to cover accrued liabilities. However, it is still not clear whether the federal courts will concur with the PBGC's interpretation of the control group rules

While it is less common today for private equity sponsors to own its interest in portfolio companies through one fund (e.g., most private equity sponsors own interests through a series of partnerships including alternative investment vehicles and thus dilute the ownership of any one portfolio company entity to less than 80%), the PBGC decision highlights the significant ramifications for private equity funds of control group liability. The decision is also a reminder that the control group rules extend beyond joint and several liability for underfunded pension plans. For example, credit agreements often prohibit pension plan underfunding for any members of a controlled group of corporations, which will require portfolio company borrowers to make representations and monitor the ERISA liabilities of other control group members of the private equity sponsor.

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