

Department of Justice Issues Important Merger-Related Guidance Focusing on Role of Due Diligence

July 2008

Introduction

On June 13, 2008, the Department of Justice (“DOJ”) issued Opinion Release 08-02, which provided no-action comfort in connection with Halliburton’s proposed purchase of the English oil-services company Expro International Group PLC (“Expro”).¹ Although Expro ultimately accepted a competing bid, the proposed purchase addressed through the Release is notable on a number of fronts including the following. First, it emphasizes the DOJ’s view of the compelling importance of due diligence, particularly in the acquisition arena. Second, it emphasizes the critical need to remediate improper conduct, including through the termination of relationships with third parties and employees. Third, it emphasizes the DOJ’s view of the importance of self-disclosure. Fourth, it clarifies to some extent the DOJ’s view of inherited liability in the acquisition context, including pre-existing joint ventures and business relations.

Background

Expro, traded on the London Stock Exchange, provides well-flow management for the oil and gas industry. At the time of the Release, Halliburton was competing with a largely foreign investment group known as Umbrellastream to acquire Expro. On June 23, ten days after the Release, Expro accepted Umbrellastram’s bid, despite Halliburton’s offer of a higher price per share. On June 26, the British High Court rejected an argument by two hedge funds that controlled 21 percent of Expro shares that the bidding should have been turned over to an auction. On July 2, Expro announced that the acquisition by Umbrellastream had been completed.

As described by Halliburton and assumed by the DOJ, U.K. legal restrictions governing the bidding process prevented Halliburton from performing complete due diligence into, among

¹ In a break from typical Opinion Release practice, Halliburton is identified by name. Typically requestors remain anonymous. Expro and other involved parties were not identified by name but were identifiable through context and publicly available sources.

other things, Expro's potential FCPA exposure prior to the acquisition. According to the Release, Halliburton had access to certain information provided by Expro, but its due diligence was limited to that information. Halliburton could have conditioned its bid on successful FCPA due diligence and pre-closing remediation. Umbrellastream's bid, however, contained no such conditions, meaning a conditioned Halliburton bid could have been rejected solely on the basis of such additional contingencies.

As a consequence of its perceived inability to conduct exacting pre-acquisition due diligence, Halliburton proposed that it conduct detailed post-acquisition due diligence coupled with extensive self-reporting through a staged process. It should be recognized that while proposed by Halliburton as part of its opinion release request, it would be usual under the circumstances for Halliburton to have made its proposal after discussions with the DOJ to ensure as best as possible that its suggested work plan would be acceptable.

First, immediately following closing, Halliburton was to meet with the DOJ to disclose any pre-closing information that suggested that any FCPA, corruption, or related internal controls or accounting issues existed at Expro. In this regard it should be noted that Halliburton claimed that its pre-existing confidentiality agreement with the target prohibited it from disclosing the potentially troublesome conduct that it uncovered through its due diligence process. As noted below, the DOJ expressed its displeasure with such an arrangement but did not foreclose proceeding with the transaction.

Second, within ten business days of the closing, Halliburton was to present to the DOJ a comprehensive, risk-based FCPA and anti-corruption due diligence work plan organized into high risk, medium risk, and lowest risk elements. The work plan was to include each of the critical due diligence areas including: (a) use of agents and third parties; (b) commercial dealings with state owned companies; (c) joint venture, teaming and consortium arrangements; (d) customs and immigration matters; (e) tax matters; and (f) government licenses and permits. Such due diligence was to be conducted by external counsel and third party consultants with assistance from internal resources as appropriate. A status report was to be provided to the DOJ with respect to high-risk findings within 90 days, medium-risk findings within 120 days, and low-risk findings within 180 days. All due diligence was to be concluded within one year with periodic reports to the DOJ throughout the process.

Third, agents and third parties with whom Halliburton was to have a continuing relationship were to sign new contracts with Halliburton incorporating FCPA and anti-corruption representations and warranties and providing for audit rights. Agents and third parties with whom Halliburton determined not to have a continuing relationship were to be terminated as expeditiously as possible, particularly where FCPA or corruption-related problems were discovered.

Fourth, employees of the target company were to be made subject to Halliburton's Code of Business Conduct (including training related thereto) and those who were found to have acted

in violation of the FCPA or anti-corruption prohibitions would be subject to personnel action, including termination.

Based on Halliburton's proposed plan (and assuming full compliance with it), the DOJ concluded that it would not undertake enforcement against Halliburton for consummating the proposed transaction – although the representation of the DOJ did not extend to the target company or its personnel. In reaching this conclusion, the DOJ emphasized that because stock ownership of the target company was widely disbursed it was not a case where the payment for the shares could be used in furtherance of earlier illegal acts of the target as distinguished from other situations previously identified by the DOJ (and discussed in more detail below).

Take-Aways

Critical take-aways from Opinion Release 08-02 are as follows:

- Critical Nature of Due Diligence:
 - Need for Pre-acquisition Due Diligence: While the DOJ issued no action relief in the context of the proposed transaction, the Opinion forcefully notes that pre-acquisition due diligence was made impractical due to operation of non-U.S. law. The message is that where such impediments do not exist, substantial and probing due diligence is expected.
 - Adequacy of Post-Acquisition Due Diligence: For the first time, the DOJ explicitly endorsed a program of post-acquisition due diligence, thereby bowing (albeit gently) to compelling commercial circumstances that would otherwise render a company subject to the FCPA uncompetitive. Such an approach should not be viewed as a softening of the DOJ's stance on the need for full compliance (as demonstrated by the rigorous post compliance protocol) but is an encouraging signal that creative approaches may be attempted and endorsed in appropriate circumstances.
 - Expectations for Due Diligence Programs: Although the Release presented an exceptional circumstance (foreign legal impediments to pre-acquisition due diligence), it can be read as further guidance on the expected scope and substance of due diligence programs. Significant emphasis was placed on conducting due diligence in all appropriate locations that includes (a) carefully calibrating risks (including the need for thorough examination of third party and governmental relationships); (b) an exacting review of broad categories of documents (including e-mail and financial and accounting records); (c) the need for witness interviews not only of the target personnel but others; and (d) the retention of outside counsel and other professionals working with internal resources as appropriate. As to the latter point, it can be speculated that the use of internal resources will be deemed

appropriate only where such resources are qualified and free of disabling conflicts.

- Remediation: A considerable emphasis is placed on the need for remediation. This includes the need (a) to terminate problematic relationships (including with employees and third parties); (b) to enter into new contractual relationships with enhanced compliance protocol (including new contracts that contain audit rights) as “soon as commercially reasonable”; and (c) to conduct effective compliance training.
- Primacy of Self-Reporting: The Release contains broad self-reporting obligations to the DOJ in all risk categories. The self-reporting aspects of the due diligence program can be seen (with the due diligence itself) as a critical basis upon which the DOJ provided its no action relief. In addition, the DOJ was careful to extend the benefits of self reporting to the target company in the context of any enforcement action the DOJ might pursue against the target and its personnel following such disclosures. The implication for the attorney-client privilege and work product protections must therefore be considered at the outset in connection with any company that might find it necessary or desirable to engage in similar self reporting.
- Successor Liability: The Release provides long-awaited clarification of Release 01-01. Release 01-01 discussed the potential for inheriting liability by a joint venture partner for corrupt activities undertaken prior to the company’s entry into the joint venture. That release dealt with a situation where the U.S. requestor sought to enter into a joint venture with a non-U.S. company and feared that, in doing so, it might violate the FCPA should it later become apparent that one or more of the contracts contributed by the non-U.S. co-venturer was obtained or maintained through bribery. Release 08-02 gives greater insight into what activities may or may not be deemed “in furtherance of” previous acts of bribery by an acquired company or joint venture partner. The Release conditionally absolves Halliburton of any such successor liability under the reasoning that the funds contributed through the purchase would overwhelmingly go to widely-disbursed public shareholders, not Expro itself, and that there is no evidence that any Expro shareholders received their shares corruptly. Implicitly, the Release can be read to endorse the view that payments to shareholders who have received their shares corruptly would violate the FCPA.
- Recognition of Previous Releases as Precedent: The Release explicitly identifies Release 01-01 as “precedent.” Such a characterization is of course at odds with the DOJ’s longstanding position (which is repeated in Release 08-02) that the Releases apply only to the specific requestor. The DOJ’s invocation of the word precedent (even if not sufficient to be relied on in court proceedings or otherwise) is certainly a window into the mind of the DOJ as to the seriousness with which companies should view the guidance offered by the DOJ in its releases.

- Caution on Confidentiality Agreements: In a footnote, Release 08-02 accepts the representation that Halliburton had to enter into a confidentiality agreement and therefore not disclose the findings of its limited due diligence review, but cautions companies seeking guidance from the DOJ on entering into agreements that limit the amount of information the company can disclose to the DOJ. Care should therefore be used in drafting and agreeing to such agreements in the future.

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