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DaMina Advisors LLP and
Curtis, Mallet-Prevost, Colt & Mosle LLP Research Paper:

Will Private Equity Firms Investing in Africa Be Affected by Violations by Portfolio Companies of the New UK Bribery Act?

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The UK Bribery Act (the "UK Act") is possibly the broadest internationally relevant anti-bribery law worldwide. The UK Act, which took effect on July 1, makes it unlawful to bribe a person, to accept a bribe, to bribe a foreign public official in his capacity as such and, for commercial organizations, to fail to prevent bribery by associated persons. The UK Act includes no limit on the fines that may be imposed for violations and provides for imprisonment of up to 10 years for individuals. This paper addresses the specific implications for private equity firms, especially those who do business in Africa or have African companies in their investment portfolios.

Associated persons. Section 8 of the UK Act defines an associated person to be an entity or individual who performs services for or on behalf of a commercial organization in any capacity, including as employee, agent, contractor or subsidiary. Thus, an employee of a portfolio company or a joint venture partner may be considered an "associated person" under the UK Act whose actions can create direct liability for a private equity firm. Pursuant to Section 8(4) whether one is an associated person "is to be determined by reference to all the relevant circumstances and not merely by reference to the nature [or title] of the relationship". Indications are that the degree of involvement the private equity firm has in the management of the portfolio company will be a factor in determining whether the portfolio company actor is an "associated person."[1] Clearly, a firm member who serves as an officer of a portfolio company or as an executive director is an associated person. However, because of the law's recent vintage, there are still no

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[1] 22 June 2011 speech by Richard Alderman, the director of the UK Serious Fraud Office. See http://www.sfo.gov.uk/about-us/our-views/director's-speeches/speeches-2011/private-equity-and-the-uk-bribery-act,-hosted-by-debevoise--plimpton-llp.aspx.

test cases, rulings or specific guidance clarifying the precise level of control or management required to cause a portfolio company actor to be considered an associated person. Thus, private equity firms would be well advised to be careful in structuring relationships.

Incentive schemes. One feature of the UK Act that could prove problematic for private e equity firms is its application to the bribery of private actors. Under the UK Act, a payment to a private actor that induces that actor to perform his duties improperly can trigger a violation. Private equity firms are typically very involved in the structuring of management and incentive plans at their portfolio companies. Such plans, if structured improperly or carelessly have the potential to violate the UK Act. For example, placement agent or brokering fees may present a particular risk. While a typical and rational incentive or management plan should not ordinarily be an issue, an overly complex web of corporate and employment or contractor relationships could appear to be a way of making third party bribes. Arrangements should therefore be commercial in nature and rational in structure, and responsibility should be taken by senior fund personnel to ensure that any monies are paid for a proper purpose.

Valuation. Among the most important issues to buyers and sellers is the effect UK Act violations will have on ultimate portfolio company valuation and exit. The diligence conducted by prospective purchasers will certainly be looking at potential UK Act violations. Ongoing warranties may be requested from sellers, and if issues are discovered in diligence, purchase price holdbacks would make sense, if a deal can be had at all in the context of potentially unlimited fines.

Investors. As a result of the issues described above, one can expect that investors in private equity funds may begin to condition investments on the implementation of procedures to ensure compliance with the UK Act and even require firms to agree to invest only in companies that are UK Act and FCPA compliant. The consequences of the later discovery of bribery or corruption issues in that case could seriously damage a fund manager's business and prospects.

Adequate procedures. The failure to prevent language of the UK Act is one of strict liability. In other words, lack of knowledge of the bribing act is not a defense. The only defense a private equity firm may have in the case of a closely managed portfolio company that is found to have violated the UK Act is that the company had in place adequate procedures designed to prevent associated persons from bribing. Unfortunately, but understandably, however, the UK Act does not include a precise definition for "adequate procedures." As such, until there are a number of test cases, it will be unclear to companies whether they have satisfied the adequate procedures

requirement. The UK government has provided some guidance as to what constitutes 'adequate procedures.' The criteria are based on six principals which are:

(1) whether the company has instituted procedures that are "proportionate to the bribery risks it faces and to the nature, scale and complexity of the commercial organization's activities";

(2) whether "top-level management are committed to preventing bribery"… and foster an associated culture;

(3) whether the company performs periodic, informed and documented internal and external bribery risk assessments;

(4) whether the company uses appropriate due diligence procedures with respect to associated persons;

(5) whether the company communicates and trains with respect to its bribery policies; and

(6) whether the company "monitors and reviews procedures designed to prevent bribery by persons associated with it and makes improvements where necessary."

Notwithstanding this guidance, without more specific rules defining adequate procedures, companies will still find themselves guessing whether they are indeed UK Act compliant. In addition, in certain circumstances, adequate procedures may all together preclude doing business in some jurisdictions.[2]

Jurisdictional reach. One must also bear in mind that the expansive reach of the UK Act could make private equity firms acting or formed outside of the UK liable under the UK Act. Not only is where the bribery act occurred not relevant in the case of an individual or entity with a close connection to the UK, in the case of failing to prevent a bribe, organizations that do any business in the UK can be liable under the UK Act regardless of where the bribe occurred and whether the bribing individual has a close connection with the UK. As a result of this broad reach, it will soon be necessary for private equity firms with any ties to the UK with operations in Africa to ensure they have undertaken appropriate and thorough due diligence in order to ensure that their portfolio companies are UK Act compliant. This will be very important for companies that do or

[2] See also, the UK Ministry of Justice, *The Bribery Act 2010 – Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)*, March 2011.

wish to do business in African countries known for so-called "gratuities" and the like. In countries where such payments would be considered necessary and not be prohibited locally, these types of payments will be difficult to prevent, and some firms may thus simply be forced to do business elsewhere and even consider divestitures. Private equity firms who are already doing business in Africa and wish to continue to do so may have to augment their due diligence efforts. Firms considering the African market need to pay special attention to diligence efforts to ensure not only current UK Act compliance, but also that procedures are in place (whether they are adequate is to be determined) to prevent bribery. Where companies do have procedures in place to prevent bribery, they need to make sure that all employees, agents or other associated persons are aware of such procedures and trained accordingly. In addition, companies need pay close attention to how court proceedings play out as the definition of what constitutes adequate procedures becomes clearer.

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