LAW360

Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

UK Joint Ventures: Sanctions And Corruption Risks

Law360, New York (June 18, 2013, 12:04 PM ET) -- Expansion into new and emerging markets is a continuing trend for companies across many industry sectors. In a number of jurisdictions, local law restricts foreign companies from establishing wholly owned subsidiaries — this is particularly true in regulated industries such as mining, banking, pharmaceuticals or telecommunications. Establishing a joint venture (JV) with a local partner is therefore a common form of entry into the market. Even if local law allows for free entry into the market, JVs can still be an attractive strategic or economic option in terms of drawing upon local expertise, skills and contacts and sharing risks, costs and resources.

While the attraction of JVs is clear, their creation and ongoing operation can present a number of issues for in-house legal teams and compliance officers. This article will consider the importance of managing the regulatory and reputational risks that can arise from operating a JV with a sanctioned partner (or a partner that becomes sanctioned), or with a JV partner who engages in corrupt practices. It will consider how to best identify sanctions and corruption risks and provide some recommendations as to action you should be taking to manage these risks — both at the outset of the creation of a new JV and as its commercial activities continue.

Joint Ventures — What Are the Risks?

Conducting business through a JV — whether your partner is known to you or not — is widely recognized as a “higher risk” business relationship in the context of sanctions and corruption risk. Similar “higher risk” arrangements would include using agents, distributors or other intermediaries.

In many jurisdictions, a company will often either have no choice as to its partner, or there will be a limited number of realistic candidates. Prospective partners may be government bodies or state-owned enterprises and/or the partner or their representatives may have connections to their country’s government or public officials — be it that they are ministers or ex ministers, they have personal or family ties to members of the government or influential figures.

Sanctions restrictions are often targeted at governments and those entities and individuals who are close to them, including state-owned companies. U.K. sanctions legislation varies in relation to the country or regime that it applies to, but will contain provisions making it a criminal offense to provide funds or economic resources[1] to a sanctioned person or entity (although receiving funds is not generally a problem or subject to licensing arrangements). It will also be an offense to “deal” with the funds (which will include shares, debt obligations and dividends) and economic resources of a sanctioned person or entity or an entity owned or controlled by a sanctioned person or entity. Any attempt to circumvent a prohibition in the legislation or enable or facilitate the commission of an offense will also amount to a criminal offense.

The Bribery Act, which came into force in the U.K. in 2011, created a number of new bribery offenses which have been widely considered and discussion of which is beyond the scope of this article. However, what should be at the forefront of the mind of any in-house counsel or compliance officer whose company operates in JVs is the offense in section 7 of the Bribery Act. Section 7 creates a strict liability offense for commercial organizations that fail to prevent bribery by those acting on their behalf (termed in the Bribery Act as their “associated persons”), where the bribery was intended to obtain or retain a business advantage for the commercial organization.

To be guilty of an offense under section 7, an organization does not need to be aware of the corrupt conduct, and will only have a defense if it can demonstrate that it had in place "adequate procedures" to prevent bribery. The term "associated person" is widely defined by the act, but may include JV partners where the partners perform services for or on behalf of one another — this would depend on the particular circumstances and operation of each JV.

Guidance published by the Ministry of Justice in relation to procedures that companies can put into place to prevent persons associated with them from bribing recognizes that JVs come in many different forms, sometimes operating through a separate legal entity, but at other times also through contractual arrangements. The guidance states that in the case of a joint venture operating through a separate legal entity, a bribe paid by the joint venture entity may lead to liability for a member of the joint venture if the joint venture is performing services for the member and the bribe is paid with the intention of benefiting that member.

It also should be noted that any company that has operations in the U.S., is listed on a U.S. stock exchange or has U.S. persons employed, particularly in its senior management, will also need to consider U.S. sanctions and anti-corruption legislation. The U.S. Department of Justice and the U.S. Securities and Exchange Commission have been seen to be particularly aggressive in investigating and prosecuting companies and individuals in relation to sanctions and corruption offenses.

What You Should be Doing

Identifying potential sanctions and corruption risks in connection with a JV should start with considering the risk profile of the proposed JV and JV partner and the ongoing commercial activities of the JV. Considering the following factors should help you to begin to assess the level of risk attaching to the JV and identify how they would be best managed:

- Whether the proposed JV and/or your JV partner will operate in jurisdictions subject to EU, UN, U.K. or U.S. sanctions.

- Whether the JV will conduct activities which are prohibited under the various EU, UN, U.K. or U.S. sanctions regimes.

- Whether the proposed JV partner has links to wider sanctioned parties through its ownership or control structure.

- Whether there is a risk that profits, dividends or loans will directly or indirectly benefit a sanctioned party.

- Whether the proposed JV and/or your JV partner will operate in jurisdictions where corruption is perceived to be high[2]. However, just because a country does not rank among the highest in terms of corruption risk, companies need to be cognizant of the risks associated with cultural practices or norms that may trigger liability under the Bribery Act.

- The industry in which the JV operates — some sectors industries, such as the oil, gas, mining and construction industries, are generally considered to be higher risk industries for corruption. Equally some sectors such as the oil and gas and telecommunications sectors are specifically targeted by sanctions.

- Whether the commercial activities of the JV will include interaction with, securing approvals or licenses from or entering into contracts with the government, public officials or public sector bodies and therefore have a higher risk of associated corrupt activities.

Joint Ventures — Managing the risks

We regularly advise companies that risk management in relation to the creation and operation of JVs can usefully have three areas of focus:

1. Appropriate due diligence on the JV partner before entering into the JV agreement.
2. Adequate contractual protections within the JV agreement, including provisions for termination or suspension
3. Monitoring and auditing the ongoing commercial operations of the JV.

Due Diligence

The scope and extent of the due diligence exercise ahead of entering a new JV should be guided by the identified risk profile of the JV and the specific nature and circumstances of the JV. However, companies should consider:

- Identifying the corporate structure, identity, ownership and control, and operational structure of the JV partner. The company name of the JV partner entity, along with all of its shareholders and directors should be screened against EU, U.K. and, if relevant U.S. sanctions lists. If any search is positive you should consider seeking legal advice to properly understand the risks and consequences of entering into the JV. Similar screening should continue through the life of the JV — see further below. Particular attention should be given to seeking to identify any hidden beneficial owners (for example companies or trust incorporated in overseas territories) and influencers (in particular, those with government roles or links to government).

- Asking questions about wider business operations and reputation of the proposed partner.

- Identifying any political links held by the partner, its shareholders or directors, including seeking to identify any press reports or allegations that these links have been used to gain a commercial advantage.

- Asking for copies of any sanctions and anti-corruption compliance policies, training materials, audits and reports.

- Asking what procedures, in addition to the policies, have been put in place to prevent bribery.[3]

- Assessing the approach to compliance within the JV partner:
    - Who is in charge of compliance — what is their background? Do they have a team to support them?
    - Is there a commitment to zero tolerance on bribery?
    - To what extent are senior management involved in developing sanctions and anti-corruption procedures?

- Where third-party agents are used by the JV partner and will continue to be used by the JV upon starting its operations, asking for information to establish how those third parties are selected, what checks are carried out in relation to the agents' identity and ownership structure, what sanctions screening is conducted and what ongoing monitoring is conducted in relation to their activities.

- If a particular corruption or bribery issue has been identified, asking how it has been addressed and what corrective actions have been put in place.

The SFO website includes a non-exhaustive list of corruption indicators[4], which should be borne in mind when conducting due diligence. These corruption indicators include:

- Abnormal cash payments.
- An abnormally high commission percentage being paid to a particular agency.
- The unusually smooth process of cases where an individual does not have the expected level of knowledge or expertise.
- Company procedures or guidelines not being followed
- The payment of, or making funds available for, high value expenses or school fees (or similar) on behalf of others.

Conducting due diligence can of course be challenging, particularly where the JV partner is located in countries where public information is inaccessible or unreliable (such as countries where the risk of corruption is higher). Bribery or corrupt activities will also not be documented, or records may have been manipulated and therefore may not come to light during due diligence.

In addition, it is important to recognize that by the nature of entering into a JV in emerging markets, a company may find itself with little or no choice in its partner. Questions as to whether for example adequate policies are in place can therefore be asked, but there is little room for maneuver irrespective of the answer. It is therefore vital to enter into a JV with “eyes open” and to seek contractual protections in the JV agreement.

Adequate Contractual Protections

In relation to sanctions risk, a company will want to be sure that, if its JV partner becomes sanctioned, it has the ability to exit the joint venture in a manner that does not itself breach sanctions. Alternatively, provisions should be included in the contract to allow the JV to continue, but to ensure that you do not risk breaching sanctions through the ongoing operations of the JV — therefore issues such as capex and opex investment into the JV, distribution of dividends and the treatment of preemption rights needs to be considered.

A key risk from a sanctions perspective is that if the JV partner becomes sanctioned and owns 51 percent or more of the JV, the JV entity itself may be listed as sanctioned, given that it is deemed to be controlled by a sanctioned entity. Contractual provisions should therefore be considered at the outset to mitigate this risk.

From an anti-corruption perspective, the JV parties may wish to consider undertakings in the JV agreement in respect of ongoing risks of corruption during the life of the JV. Standard undertakings include that each joint venture partner:

- Will not, and will procure that the JV will not, engage in any activity, practice or conduct which would constitute an offense under the Bribery Act.

- Has and will maintain in place, and will procure that the JV has and will maintain in place, adequate procedures in line with the Guidance designed to prevent associated persons from undertaking any such conduct.

Provision should also be considered for an offending partner to assume all direct and indirect costs associated with a violation and/or to allow for exit from the JV in such a situation.

It is advisable that JV agreements require all partners to have sanctions and anti-corruption policies and training programs in place which apply to all employees and third parties that will interact with the JV.

In terms of the ongoing activities of the JV, the parties will also need to consider how they can effectively monitor the ongoing policies and procedures put in place by the JV and how this should be provided for in the JV agreement. This could be, for example, an annual reporting obligation, an audit requirement to be imposed on the internal audit function in the JV, or for one party to be able to freely audit the activities of the JV.

The JV parties may also wish to consider specific undertakings or provisions relevant to industry or sector in which JV will operate.

Ongoing Commercial Activities

In February 2011, Richard Alderman, the then head of the U.K.'s Serious Fraud Office stated that the SFO would make a distinction between new and existing JVs. He stated, "for existing [JVs], we are sympathetic to them being tied into these very complicated arrangements. If they have done everything they can we will be satisfied with that. New ones will have to build in auditing and transparency provisions."

Alderman has since been replaced by David Green QC who is widely thought to take a more aggressive approach to investigations and prosecutions. However, what is clear for JVs is that the signing of the JV agreement is not end of sanctions and corruption risk management:

- The regular monitoring and auditing of the activities of the JV is key and allows for the early identification of any potential concerns.

- Employees both new and existing should be given regular training on sanctions and anti-corruption compliance. There should also be regular assessments of whether employees truly understand what behavior is appropriate.

- In relation to sanctions risks, regular monitoring and screening of the JV partner should be considered.

JVs can be a necessary and highly effective way to engage in lucrative commercial operations. A considered, proportionate and risk based approach to the creation and operations of a JV should give companies the comfort they are looking for.

—By Miriam Gonzalez, Jonathan Pickworth, John Forrest and Chloe Barker, Dechert LLP

Miriam Gonzalez and Jonathan Pickworth are both partners in Dechert's London office. John Forrest is a director in the firm's London office. Chloe Barker is an associate in the London office.

[1] Defined widely to cover any form of benefit.

[2] For further information, consult for example Transparency International's corruption perception index at http://www.transparency.org/research/cpi/overview.

[3] The Guidance notes that procedures should be proportionate to the bribery risks that an organization faces.

[4] http://www.sfo.gov.uk/bribery - -corruption/corruption-indicators.aspx