

### ***Why Perform Due Diligence?: “That’s PR Speak for fraud”***

Yesterday brought some very interesting news from both ‘across the pond’ and here in the US. From the UK, there was the news of the arrests of former News Corp head honchos Rebekah Brooks, who ran Murdoch's newspaper holdings in Britain, Andy Coulson, former editor of the now defunct News of the World. Dominic Rushe, writing in the Guardian, quoted the FCPA Professor who said it “would be hard for the Department of Justice [DOJ] and the Securities and Exchange Commission [SEC] to ignore. We have been hearing allegations for a year and a half now, now we clearly have charges against high ranking officials at a foreign subsidiary.” More ominously, Rushe cited to a report from The Daily Beast that the “Daily Beast alleged that the Murdoch tabloids the Sun and the New York Post may have made payments to a US official on American soil in order to obtain a photo of a captive Saddam Hussein, the deposed Iraqi leader, in his underwear.” Rushe did note that “News Corporation has denied the claims.” But we will leave a more detailed discussion of the events for a later post.

The second piece of news was almost as breath-taking. As reported in the Wall Street Journal (WSJ), Hewlett-Packard (HP) wrote down \$8.8bn of its \$11bn purchase value of the UK Company Autonomy. HP said “that an internal investigation had revealed "serious accounting improprieties" and "outright misrepresentations" in connection with U.K. software maker Autonomy.” Further, according to HP Chief Executive Officer (CEO) Meg Whitman, ““There appears to have been a willful sustained effort" to inflate Autonomy's revenue and profitability. This was designed to be hidden.” Speaking more bluntly (as always) Francine McKenna, in her post entitled “*Hewlett-Packard's Autonomy Allegations: A Material Writedown Puts All Four Audit Firms On The Spot*”, in forbes.com said “That’s PR-speak for fraud.”

Not to be outdone, the WSJ reported that “Michael Lynch, Autonomy's founder and former CEO, fired back hours later, denying improper accounting and accusing H-P of trying to hide its mismanagement. “We completely reject the allegations," said Mr. Lynch, who left H-P earlier this year. "As soon as there is some flesh put on the bones we will show they are not true.”” In other words, Lynch accused HP of mismanaging his former company and destroying its value in less than 12 months. It should also be noted that the Autonomy acquisition was pushed through by the former CEO of HP, Leo Apotheker; not the current CEO.

I thought about the HP story in the context of the section in the recently released DOJ/SEC A resource Guide to the U.S. Foreign Corrupt Practices Act (FCPA) on successor liability and why a company needs to perform pre-acquisition due diligence:

*First, due diligence helps an acquiring company to accurately value the target company. Contracts obtained through bribes may be legally unenforceable, business obtained illegally may be lost when bribe payments are stopped, there may be liability for prior illegal conduct, and the prior corrupt acts may harm the acquiring company’s reputation and future business prospects. Identifying these issues before an acquisition allows companies to better evaluate any potential post-acquisition liability and thus properly assess the target’s value.*

It should be noted that Autonomy's outside auditor before the deal, Deloitte UK, gave the company a clean bill of health. Further, HP had its own outside auditor, KPMG, brought in at the pre-acquisition stage to conduct due diligence work, which was essentially to check Deloitte's audit work of Autonomy. In other words, two of the world's top auditing firms passed muster over Autonomy's books and records and gave the entity's financial statements a passing grade.

Once, when asked why men play football, Jet coach Herm Edwards emphatically said "You play to win the game." I think people need to realize that compliance due diligence under the FCPA can also be used to help company's do more than uncover potential FCPA issues but also help correctly assess the value of target companies. It might help prevent multi-billion dollar write downs. Unless of course the target company has engaged in an on-running, long term fraud...

Happy Thanksgiving to all...

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