

Opening Day is Here - Hope and Melancholy for the Astros and Avon

It is finally here, Opening Day for the Houston Astros. Although Major League Baseball (MLB) opened its 2012 season last week in Japan, I will have to go with my hometown team's home opener as my official day for the new season. So will the Astros improve on their 106-loss season from 2011? We can certainly hope so. On a somewhat melancholy note, it is the Astros final season in the National League (NL) as new owner Jim Crane threw away our 50 year tradition by agreeing to move the Astros to the American League (AL) West next year. Thanks Jim. But hey, we can still lose games to Albert Pujols, when we are up in the 9th by two runs as he left the St. Louis Cardinals for the mega-zillions of Anaheim's Angels, when he hits yet another 3 run homer with a 0-2 count.

This week in the compliance world we saw a different type of opening or perhaps the beginning of the end, depending on your perspective, involving Avon. The news this week was not specifically focused on its ongoing Foreign Corrupt Practices Act (FCPA) travails but the takeover bid by a much smaller rival, Coty, Inc. As reported in the April 3, edition of both the Wall Street Journal (WSJ), "*Scarred Avon is Takeover Target*", and the New York Times (NYT), "*Avon Rebuffs Coty, but Its Weakness Shows*", the German-based cosmetics concern, which is "less than half Avon's size", publicly announced a \$10 billion takeover bid for Avon.

FCPA Costs for Avon

The FCPA travails of Avon have been well reported. In October 2008, Avon publicly announced it was conducting an investigation for possible FCPA violations related to its China operations. This investigation expanded into a world-wide internal investigation, which at this time is still ongoing with no indication of when an enforcement action, if any, will be concluded. Recently the **FCPA Professor**, in a post entitled "*Business Effects*", reported that the "professional fees and expenses incurred by Avon in connection with its internal FCPA review have approached \$250 million – and there hasn't even yet been an enforcement action. Over the past three years and doing the math, Avon has spent approximately \$225,000 per day on its FCPA inquiry." As reported by the **FCPA Blog**, in a post entitled "*Suit Alleges Avon Execs Knew About China Bribes*", a recent article by Chris Matthews of the WSJ "reported yesterday that an amended shareholder lawsuit accuses Avon Products of paying a big severance to a former head of internal audit in 2006 to buy his silence about bribes in China."

In addition to this civil shareholder lawsuit, the FCPA Blog noted that "Joe Palazzolo and Emily Glazer at the Wall Street Journal said in February that the DOJ [Department of Justice] had gone to a grand jury with evidence of FCPA violations against U.S. executives at Avon Products. The WSJ story, based on at least three unnamed sources, said the focus of the grand jury was a 2005 internal audit report by the company that concluded Avon employees in China may have been bribing officials."

In addition to its FCPA issues, Avon has suffered financial setbacks as well since the original FCPA disclosure. The NYT reported that Avon's "net income has declined every year since 2008." It has lost significant stock value during this FCPA investigation and has had its credit downgraded. The WSJ article reported that "Prior to Coty's offer, Avon's stock had lost about 30% of its value over the past year, and Standard & Poor's Corp. cut its credit rating on Avon last month to triple-B, two steps above junk, warning it could fall further as the search for a CEO keeps longer-term planning on hold." This final reference is to Avon's move to replace its chief executive Andrea Jung, as reported in the NYT article, "has been criticized by analysts recently."

Successor Liability Issues under the FCPA

As noted by reporter Sam Rubinfeld, in a WSJ article entitled "*Buying Avon Could Bring Coty A Hefty Bribery Risk*", the purchasing entity Coty "could be buying a massive foreign bribery liability if a deal to purchase Avon Products Inc. were to close, experts said." He wrote that "Successor liability in the FCPA context, known by the shorthand of "buying an FCPA violation," was the subject of six enforcement actions in 2011." He went on to quote Rita Glavin, a partner at Seward & Kissel LLP who formerly served as head of the Justice Department's Criminal Division, who said "You buy a company, you buy their problems."

So what is Coty up to here? I think that they may have come upon an interesting new wrinkle for companies in a FCPA investigation. Not only do companies face what Avon has gone through in terms of the business effects of a huge cost for an internal investigation, drop in stock value and drop in credit rating but now such an all-encompassing investigation could put a company in play for a takeover - hostile or friendly. While the doctrine of successor liability is alive and well, there are potential protections for any purchaser. First and foremost is the fact that it is Avon which has borne these tremendous costs for the investigation. I have no doubt that as a part of the investigation Avon has identified compliance policies and procedures which should be (*ahem*) enhanced to prevent any violations of the FCPA going forward. Once again it is Avon which is doing this work and not any acquiring company. In addition to these costs which the acquiring company does not have to incur, the value of Avon is well down, although just how much due to the FCPA investigation may not be quantified at this point, it does not change the fact that its value is significantly lower. Hence any purchase price will be at a reduced amount perhaps even a greatly reduced amount.

Coty Options on Successor Liability Issue

As to the issue of successor liability, I think that Coty can look to different DOJ pronouncements for some comfort. The first is Opinion Release 08-02 (the "Halliburton Opinion Release") in which the DOJ blessed a go-forward plan proposed by Halliburton, to accomplish due diligence in a post-acquisition mode. The second is found in the Johnson and Johnson (J&J) Deferred Prosecution Agreement (DPA), in Attachment D, "Enhanced Compliance Obligations." With regard to the acquisition context, it agreed to:

7. J&J will ensure that new business entities are only acquired after thorough FCPA and anticorruption due diligence by legal, accounting, and compliance personnel. Where such anticorruption due diligence is not practicable prior to acquisition of a new business for reasons beyond J&J's control, or due to any applicable law, rule, or regulation, J&J will conduct FCPA and anticorruption due diligence subsequent to the acquisition and report to the Department any corrupt payments, falsified books and records, or inadequate internal controls as required by ... the Deferred Prosecution Agreement.

8. J&J will ensure that J&J's policies and procedures regarding the anticorruption laws and regulations apply as quickly as is practicable, but in any event no less than one year post-closing, to newly-acquired businesses, and will promptly: For those operating companies that are determined not to pose corruption risk, J&J will conduct periodic FCPA Audits, or will incorporate FCPA components into financial audits.

a. Train directors, officers, employees, agents, consultants, representatives, distributors, joint venture partners, and relevant employees thereof, who present corruption risk to J&J, on the anticorruption laws and regulations and J&J's related policies and procedures; and

b. Conduct an FCPA-specific audit of all newly-acquired businesses within 18 months of acquisition.

Mike Volkov, writing in his blog, **Corruption, Crime and Compliance**, in a post entitled "*Buying an FCPA Violation: Successor Liability is Alive and Well*", provided the following advice for companies to steer clear of successor liability under the FCPA in an acquisition context:

1. A pre-closing risk assessment needs to be updated for post-closing risks.
2. Compliance triage teams need to be assembled and tasks prioritized. If more resources are needed, this needs to be arranged at or near the time of closing. Compliance triage teams must have authority and resources to bring an acquired company into the fold.
3. Compliance triage teams need to work post-acquisition to ensure proper controls and compliance programs are adequately implemented in those high-risk areas and businesses.
4. Compliance training of new employees and agents has to be a high priority. It is surprising how many companies fail to even conduct basic training, updating of codes of conduct and basic steps to integrate new employees and agents.

From Opinion Release 08-02, the J&J DPA and Mike Volkov's thoughts, I believe that Coty could well put together a plan to deal with Avon's FCPA issues and the DOJ based upon precedent, a strong commitment towards compliance going forward and Coty's extraordinary

cooperation with the DOJ to make all of this work. Although the NYT and WSJ both reported that Avon's management rejected the Coty offer, if Coty can convince enough Avon shareholders to accept the offer the Avon shareholders might be inclined to consider such an offer at this point.

But it's Opening Day and my bride and I are off to Minute Maid Park to watch the hometown heroes play the Colorado Rockies tonight. Is the start of this 2012 a harbinger of good things to come for the Astros? Only time will tell. As for Avon, its FCPA travails may have helped to put it in play and Coty may have figured out how to use one company's FCPA issues as a springboard to a major acquisition. Maybe the new normal for companies in large FCPA investigations/enforcement actions is that they find themselves as take-over candidates. Only time will tell.

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