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Anti-Corruption Challenges for Private Equity in Asia

Asia, a continent with more than one-half of the world's population and a diverse array of economies, has been a focus of investment and, increasingly, capital raising for private equity firms. The diversity of Asia's markets, both in size and levels of development, presents both opportunities and risks to private equity funds.

Private equity firms have long recognized corruption as a potential risk in most Asian markets. With the exception of a small number of highly developed markets, most jurisdictions in Asia score poorly on corruption indices. While risks associated with enrolling limited partners (many of whose employees and representatives are "foreign officials" under the U.S. Foreign Corrupt Practices Act ("FCPA")) and with the use of agents to source deals when deploying capital in obtaining government approvals to invest are present in most markets, the prevalence of corruption in many parts of Asia and the ubiquity of "foreign officials" as business-related decision-makers in several Asian markets present unique risks to investors.

The FCPA has traditionally been the primary source of legal risk, as the recent interest in the hiring practices of financial services firms in China underscores.[1] However, the local anti-corruption efforts in various Asian jurisdictions pose their own legal and reputation risks, as China's recent crackdown on pharmaceutical and consumer products sectors[2] and the increasingly aggressive enforcement efforts by local authorities in Indonesia, Malaysia, and India demonstrate.[3] As the focus of private equity activity increasingly expands beyond India and China, the need to remain vigilant with regard to corruption risk will continue. This vigilance, however, is not simply a cost related to the challenge of operating in markets characterized by pervasive corruption. Addressing corruption risks in these markets can also be an opportunity for private equity funds to increase the value of a portfolio investment.

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1. *See* Paul R. Berger, Bruce E. Yannett, Sean Hecker, Philip Rohlik and Steven S. Michaels, "Hiring Relatives of Foreign Officials: the DOJ's Guidance, Some Key Issues, and Potential Internal Controls Solutions to a Recurring Issue Under the FCPA," *FCPA Update*, Vol. 5, No. 1 (Aug. 2013), http://www.debevoise.com/fcpa-update-08-27-2013/.

2. *See, e.g.*, Dexter Roberts, "China Makes Life Hard for Multinationals," *Business Week* (Sept. 19, 2013), http://www.businessweek.com/articles/2013-09-19/multinationals-glaxo-bayer-and-eli-lilly-feel-the-wrath-in-china.

3. *See* Christopher K. Tahbaz, Philip Rohlik, Xia Li, Bruce E. Yannett and Andrew M. Levine, "Spotlight on Southeast Asia," *FCPA Update*, Vol. 4, No. 11 (June 2013), http://www.debevoise.com/fcpa-update-06-26-2013/.

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I. Opportunities and Corruption Risk in Asia

The Asia region offers unique opportunities to investors. The region's rapidly growing share of global wealth now accounts for just under 30 percent of world GDP. Although the region is less developed than North American or European private equity markets, private equity investment into Asia reached US$ 65 billion in 2011, according to a survey by McKinsey & Company.[4] The variety of markets in Asia also offers opportunities to investors looking to tailor their portfolios. China and India are developing markets that are so large that they defy easy categorization. Japan, Singapore, South Korea and Hong Kong SAR are first world economies, while Malaysia and Thailand have a long history of development and are what the World Bank refers to as "upper middle income countries."[5]

The region also includes rapidly growing post-socialist economies, such as Vietnam, and developing countries, such as Indonesia and the Philippines, with young and growing populations and the need for expanded infrastructure. The "frontier markets" of Myanmar, Laos and Cambodia, each of which is unique in several respects, have only recently opened up to international investment. Countries such as Mongolia, Laos, Myanmar and Indonesia are rich in natural resources, while Vietnam, Indonesia, China and India have vast and fast-growing consumer classes. Some developing countries, like China, Laos, Vietnam and (until recently)[6] Cambodia, exhibit a high degree of political stability while others, such as Thailand and the Philippines, do not. The Chinese Yuan Renminbi remains a controlled and stable currency that has appreciated, steadily, over time, while other currencies fluctuate wildly and, especially in recent months, have depreciated, particularly the Indian Rupee and Indonesian Rupiah.[7]

Unfortunately, despite these differences, one characteristic shared by many countries in the region is endemic corruption. Only Japan, Singapore, Taiwan, Hong Kong SAR, South Korea and Brunei score above 50 in the most recent Transparency International Corruption Perceptions Index ("TI CPI"); a score below 50 is indicative of "a serious corruption problem."[8]

Other Asian countries have scores ranging from 49 for Malaysia, 39 for China, 36 for India, 32 for Indonesia, and all the way down to Myanmar, which has a score of 15, placing its corruption risk somewhere between that of Uzbekistan and Sudan.[9]

With the exception of Malaysia, which just missed the 50 point threshold and has a decades-long history of rule of law, the relative rankings of other Asian countries scoring

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4. Chinta Bhagat, Keiko Honda, Vivek Pandit, Gary Pinshaw, Bruno Roy and Youngwook Yoo, "Private Equity in Asia-Pacific: Is the Boom Back?," *McKinsey & Company Private Equity and Principal Investing*, May 2012 at 1.

5. The World Bank, *Malaysia*, http://data.worldbank.org/country/Malaysia ("Income level: upper middle income"); The World Bank, *Thailand*, http://www.worldbank.org/en/country/Thailand ("Thailand is one of the great development success stories. Due to smart economic policies it has become an upper middle income economy…").

6. Sun Narin and Chun Han Wong, "Cambodian Opposition Stages Mass Protest Over Disputed Vote," *The Wall Street Journal* (Sept. 7, 2013), http://online.wsj.com/article/SB10001424127887323623304579060510373980496.html.

7. *See, e.g.*, Nathaniel Popper, Currency Volatility is Unnerving Investors," *The New York Times* (Aug. 20, 2013), http://dealbook.nytimes.com/2013/08/20/fluctuations-in-currencies-roil-markets/.

8. Transparency International, *Corruption Perceptions Index 2012*, http://cpi.transparency.org/cpi2012/results/ ("While no country has a perfect score, two-third of countries score below 50, indicating a serious corruption problem.").

9. *Id.* Myanmar's score is probably a lagging indicator as anecdotal reports from potential investors and due diligence firms suggest that the country's drive to open itself up to foreign investment has led to a marked reduction in demands for bribes made to potential investors.

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Debevoise & Plimpton LLP

919 Third Avenue
New York, New York 10022
+1 212 909 6000
www.debevoise.com

Washington, D.C.
+1 202 383 8000

Moscow
+7 495 956 3858

London
+44 20 7786 9000

Hong Kong
+852 2160 9800

Paris
+33 1 40 73 12 12

Shanghai
+86 21 5047 1800

Frankfurt
+49 69 2097 5000

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below 50 on the TI CPI should not be overstated. Significant alleged bribes in the procurement context can be found in the reports of local investigations and prosecutions throughout the region.[10] Kickbacks form part of many transactions in China and Vietnam, and both countries have a culture of relationships that, unfortunately, provide fertile soil for corrupt behavior.[11] Demands for money, ranging from facilitation payments to something more, form part of many interactions with civil servants at every level in India, Indonesia and Cambodia. The Philippines is characterized by pervasive nepotism and petty bribery. Corruption pervades the region, and it would be extremely naïve to imagine that any local company, especially a smaller company with high growth potential of the type often targeted by private equity firms, is untouched by it. Managing that risk and realizing how doing so can result in rewards at the time of exit from an investment is the challenge facing investors.

II. Private Equity in Asia

Fund managers active in the Asian private equity market include international players, such as Carlyle, Bain and Blackstone, and an increasing number of Asia-based fund managers located either in the international financial centers of Hong Kong and Singapore, or based in their home jurisdiction, in particular, China.

"Significant alleged bribes in the procurement context can be found in the reports of local investigations and prosecutions throughout the region."

Although deals vary greatly by market, generally speaking PE investments in Asia have traditionally been minority investments.[12] Since 2005, more than 90 percent of private equity deals in greater China and India and just over 70 percent of those in Southeast Asia have been minority investments.[13] The prevalence of minority investments is one of the most significant ways in which Asian PE deals differ from their U.S. and European counterparts.[14] Especially in developing and nominally socialist markets, minority investments are often necessary (1) in order to comply with restrictions on foreign ownership in certain sectors and (2) given that the target company is often managed by its entrepreneurial founder (or the founder's family), who may be reluctant to cede control of the business.

Although a listing on either a local exchange or in Hong Kong or Singapore has traditionally been the preferred manner of exiting private equity portfolio company status in Asia,[15] IPOs on local markets have slowed as a result of the volatility of many regional markets and the embargo on new listings on Chinese exchanges imposed by the Chinese Securities Regulatory Commission ("CSRC") in October 2012.[16] A recent Ernst & Young survey found that trade sales constituted the majority of anticipated exits in all markets other than Greater China, Japan and South Korea.[17]

III. Private Equity Corruption Risks in Asia

Private equity firms seeking to invest in the Asian market are exposed to a number of corruption-related risks. Those risks depend in part on whether a fund or a fund manager is an issuer or subsidiary of an issuer under the Securities Exchange Act of 1934, employs U.S. nationals, is a domestic concern or affiliate of a U.S. domestic concern, or otherwise is likely to be subject to the FCPA, the UK Bribery Act 2010 or any other transnational anti-bribery regime. But given the increase in local anti-corruption enforcement, the prevailing best practice is to focus on corruption risk as it

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10. *See, e.g.*, Laura Zhou "Former high-speed rail chief admits taking 47 million yuan in bribes," *South China Morning Post* (Sept. 11, 2013), http://www.scmp.com/news/china/article/1307948/former-high-speed-rail-official-zhang-shuguang-admits-taking-47-million; Indo-Asian News Service, "CBI files charge sheet in Karnataka illegal mining case," *dnaindia.com*, http://www.dnaindia.com/india/1889875/report-cbi-files-charge-sheet-in-karnataka-s-illegal-mining-case.

11. *See, e.g.*, Daniel Chow, *The Interplay Between China's Anti-Bribery Laws and the Foreign Corrupt Practices Act*, 73 Ohio St. L.J. 1015, 1017 (2012).

12. Bhagat et al, *supra* note 4, at 5, 8.

13. *Id.*

14. *See* Ernst & Young LLP, "Feature Article: Making an Exit," *Asia Private Equity Outlook 2013* at 49.

15. *See id.*; *see also* Bhagat et al, *supra* note 4, at 5, 8.

16. Bloomberg News, "IPO-Eager Chinese Companies Await New Regulations," *Business Week* (Aug. 1, 2013), http://www.businessweek.com/articles/2013-08-01/ipo-eager-chinese-companies-await-new-regulations.

17. Ernst & Young LLP, "Deal Flow and Exit Options," *Asia Private Equity Outlook 2013* at 26.

exists without regard to which government might prosecute a bribery-related offense. The stark reality in Asia in 2013 is that if bribery is discovered, publicized, or otherwise comes to the attention of government authorities anywhere, it is increasingly likely to be investigated and prosecuted by at least one and, for multinational firms, more likely several different enforcement authorities.

Seen in this light, fund managers face the same risks when operating in the region that all businesses, especially financial firms, face. Fund managers are exposed to the same sort of third-party risk as any company using agents when fund managers retain a third party to assist in sourcing a deal or obtaining regulatory approval for an investment. As with other financial institutions, fund managers should also be mindful of benefits provided to representatives of limited partners (whose employees, in the case of public pension funds and sovereign wealth funds, among other entities, often qualify as "foreign officials" under the FCPA) and of remuneration provided to foreign officials who serve on advisory and other boards.

Similarly, the recently announced investigations into hiring practices in China should also be borne in mind.[18] Although the risk is magnified in China, Laos and Vietnam, where a large segment of the population could arguably be considered "foreign officials" under the enforcement agencies' expansive interpretation of the FCPA, there are also a significant number of state-owned enterprises in many of the other Asian countries, including particularly in Indonesia, and disclosed or undisclosed participation of officials in nominally private enterprises is also common.

Private equity firms and similar investors often face unique anti-corruption challenges in Asia, where, as noted above, most private equity investments constitute minority positions. Just as corporations can be liable for acts of their subsidiaries, private equity investors could under certain circumstances be liable for the actions of portfolio companies if (among other facts required by the elements of FCPA offenses): (1) the portfolio company can be said to be acting as the agent of the fund or (2) the fund or fund manager participates in or authorizes the corrupt activity and investors are sufficiently aware of the misconduct and take no action in circumstances that could give rise to a finding of authorization, ratification, conspiracy, or aiding or abetting.[19] Although this liability is easier to prove if the investor owns more than 50 percent of a portfolio company's equity, liability can also arise in connection with minority positions. Finally, employees of the fund manager serving on portfolio company boards or seconded to portfolio companies could also face personal liability under the FCPA or UK Bribery Act if they are U.S. or U.K. nationals or work for a fund manager that falls under the jurisdiction of one of those acts.

The law of agency is the standard means by which a parent company is held liable for the acts of subsidiaries. The fundamental characteristic of an agency relationship between a subsidiary and its parent company is control and direction by the parent company, and "control and direction" are determined based on the facts as they actually exist, rather than on corporate formalities. Although most FCPA cases involving allegations of parent company liability for the acts of a subsidiary have involved wholly owned or majority-owned subsidiaries, a finding of agency is possible even in a minority investment. Although a small percentage ownership is extremely unlikely to be found to create an agency relationship, a minority position with significant day-to-day control rights could be interpreted as giving an investor control, in the same fashion that "control-in-fact" is determined for purposes of consolidating a minority investment's financial returns under accounting rules.[20]

Regardless of whether an agency relationship exists, investors are exposed to liability when they participate in wrongdoing or approve actions with knowledge that bribery will be involved. In such circumstances, even small minority positions could lend themselves to FCPA liability. For example, an investor's approval rights might not be sufficient in general to create an agency relationship, but the exercise of those approval rights in the context of approving the retention of an agent whom the investor knows intends to pay a bribe could qualify as "authorizing" a corrupt payment under 15 U.S.C. §§ 78dd-1(a)(1), 78dd-2(a)(1), and 78dd-3(a)(1) as well as the alternative jurisdictional provisions of the statute. Although not yet tested in enforcement actions, the argument could be made that any investment of any size (including an investment intended

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18. *See* Berger et al., note 1, *supra*.

19. 15 U.S.C. §§ 78dd-1(a)(1), 78dd-2(a)(1), and 78dd-3(a)(1). *See also United States v. Bourke*, 667 F.3d 122 (2d Cir. 2011) (FCPA conspiracy liability).

20. *See, e.g.*, Emerging Issues Task Force Memorandum 96-16, http://www.fasb.org/pdf/abs96-16.pdf, and FIN 46R, http://www.fasb.org/pdf/aop_FIN46R.pdf, as amended and superseded.

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to be passive) into a portfolio company while the investor knows that the portfolio company will use some of the funds to pay bribes would, on its face, be a violation of 15 U.S.C. §§ 78dd-1(a)(3), 78dd-2(a)(3), and 78dd-3(a)(3) which prohibit offering, promising or providing anything of value to "any person, while knowing that all or a portion of such thing of value will be offered, given or promised, directly or indirectly to any foreign official …."

> "[Transaction] diligence normally includes background investigation and reputation checks of the target company and possibly its principals, investigation into the ownership of the target and questions relating to the target's internal controls, policies and expenses."

IV. Due Diligence: Assessing Risk and Determining Proper Value

Knowledge that a bribe will be offered, authorized or paid – an essential element of the primary anti-bribery offenses codified by the FCPA – includes actual knowledge and conscious avoidance or willful blindness.[21] Although some might argue that any investment into a local company (not otherwise subject to the FCPA or similar law) in a particularly high-risk jurisdiction involves at least some probability that the local company has paid or is disposed to pay a bribe, there is a difference between knowledge and willful blindness on one hand, and a realistic assessment of the reasons behind the low scores on corruption indices and how such reasons translate into business practices among companies (not otherwise subject to the FCPA) in such markets.[22] Nevertheless, to minimize the risk of an accusation of conscious avoidance or willful blindness at the time of an investment and thereafter, a fund manager should undertake meaningful due diligence on the target. This due diligence can be incorporated into standard deal due diligence. The amount of diligence should be risk-based, reflecting the corruption risks of the jurisdiction and industry sector of the target.

Such diligence normally includes background investigation and reputation checks of the target company and possibly its principals, investigation into the ownership of the target and questions relating to the target's internal controls, policies and expenses. In the context of minority private equity deals common in Asia, this diligence will often necessarily be more limited than diligence in a control context, but should be proportional to the financial and other deal diligence undertaken. Under certain circumstances, investors in club deals might also consider whether due diligence of investment partners should also be undertaken.

The amount of diligence that should be undertaken can also be limited by law in some Asian jurisdictions. As elsewhere, diligence for a Private Investment in Public Equity ("PIPE") transaction is limited by securities laws prohibiting dissemination of inside information. In most of the developing markets in Asia, publicly available information, such as public filings, can be incomplete and untrustworthy. Additional sources of information may not be public and accessing such sources can itself be illegal. In China, the ability to conduct any due diligence has recently been significantly restricted. The State Administration of Industry and Commerce severely limited access to corporate filings in 2012.[23] Further, the PRC's state secrets laws could be interpreted to prohibit the transfer to certain types of financial and other information outside the country, as was the case with information in the possession of Deloitte & Touche's Chinese affiliate related to Longtop Financial Technologies.[24] Although U.S. regulators and the CSRC have reached an agreement with regard to audit records,[25] the Chinese state secrets law principles could be seen as applying equally to similar data collected during diligence.

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21. H.R. Rep. No. 100-576 at 920 (1988), *reprinted in* 1988 U.S.C.C.A.N. 1547, 1953.

22. *See* Sean Hecker and Steven S. Michaels, "*Global Tech Appliances, Inc. v. SEB S.A.*: From Deep Fryers into the Fire of the 'Willful Blindness' Doctrine," *FCPA Update*, Vol. 2, No. 11 (June 2011).

23. Lucy McNulty, "Revealed: China corporate records policy shift to harm hedge fund and PE access," *IFLR* (June 1, 2012), http://www.iflr.com/Article/3040279/Corporate/Revealed-China-corporate-records-policy-shift-to-harm-hedge-fund-and-PE-access.html.

24. *See, e.g.*, Peter J. Henning, "Deloitte's Quandary: Defy the SEC or China" *The New York Times* (Oct. 20, 2011), http://dealbook.nytimes.com/2011/10/20/deloittes-quandary-defy-the-s-e-c-or-china/.

25. Dena Aubin and Sarah N. Lynch, "U.S. audit regulator reaches deal with China on document access," *Reuters* (May 24, 2013), http://www.reuters.com/article/2013/05/24/us-usa-auditing-china-idUSBRE94N0VO20130524.

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The sensitivity of the Chinese government to diligence activities has become especially acute since the arrest of diligence provider Peter Humphreys in July 2013.[26] Obviously, local law and practical limitations on due diligence must be taken into account, both in the due diligence itself and in the decision to invest.

Nevertheless, diligence not only protects against allegations of conscious avoidance but also allows an investor to value accurately a proposed investment. To the extent the investor discovers potentially improper activity or significant red flags on the part of a potential portfolio company, the investor can discuss such activity with the principals of the target. This type of discussion has merits beyond anti-corruption due diligence, as it gives the investor a chance to assess the integrity of the principals. To the extent that ending the potentially improper payments will reduce future cash flows and, as a result, the value of the investment, that reduction can be reflected in the transaction price.

In a minority investment, it is possible that the principals will refuse to change their behavior. Under such circumstances, the investor can make a judgment about significant legal and reputation risk of entering the transaction and the complications that such behavior might generate when the investor seeks to exit. In making this judgment in the context of a minority investment, it is important to take into account that not all red flags are alike, and it usually will be impossible to eliminate all corruption risk. Of course, making a minority investment in a company while knowing that the provision of envelopes of cash to government officials is part of the company's business plan presents significantly more legal and practical risk than does making such an investment while knowing merely that the company's practices with regard to gifts, meals and entertainment fall short of FCPA best practices.

Legal liability and reputation risks are particularly acute for fund managers who are subject to the FCPA. Even fund managers not subject to the FCPA are advised to take such risks into account, given increasingly aggressive enforcement of anti-corruption in certain jurisdictions and the fact that the same questions could be asked at the time of exit, if exit involves a trade sale to an international buyer.

V. Adding Value: Exit Benefits of Anti-Corruption Controls

Either in the deal documents or, after an investment is undertaken, through submission of resolutions for vote by the board of directors, an investor can further protect itself by encouraging, if not requiring, the portfolio company to adopt anti-corruption controls. A controlling investor can require that such controls be adopted and, depending on the size of the investment, even a minority investor can make the adoption of such controls a condition of the investment. Even if the deal dynamics do not permit an investor to require the adoption of such controls, encouraging their adoption adds value to a portfolio company, a primary goal of private equity firms.

Anti-corruption controls also can be a significant benefit in an exit that takes the form of a trade sale to an international corporation, which itself is likely to be subject to the FCPA or the UK Bribery Act. Similarly, while anti-corruption compliance itself might not be a topic of particular concern to listing committees on Asian exchanges, the types of accounting systems and compliance programs needed for effective anti-corruption controls will assist with satisfying a listing committee or other relevant regulators if the exit from the investment is undertaken through a public stock or debt offering.

VI. Conclusion

Asia presents a vast range of markets, challenges and opportunities to private equity firms and those who look to such firms as a source of income. As with political risk or currency risk, a realistic assessment of both the challenges and opportunities presented by anti-corruption compliance associated with investment in the region is necessary prior to investment. Such an assessment can allow private equity funds to determine the most appropriate regional balance in deploying funds as well as to realize increased value in an exit from a recently compliant company.

Sean Hecker
Andrew M. Levine
Philip Rohlik

Sean Hecker and Andrew M. Levine are partners in the firm's New York office. Philip Rohlik is a counsel in the firm's Hong Kong office. They are members of the Litigation Department and the White Collar Litigation Practice Group. The authors may be reached at shecker@debevoise.com; amlevine@debevoise.com, and prohlik@debevoise.com. Full contact details for each author are available at www.debevoise.com.

26. Patti Waldmeir, "British fraud investigator in China TV confession," *Financial Times* (Aug. 27, 2013), http://www.ft.com/intl/cms/s/0/5bf8c860-0ecb-11e3-81ab-00144feabdc0.html#axzz2fVgTRrph.

NEWS FROM THE BRICs

India Tightens Corporate Governance Norms and Moves Towards a More Transparent Companies Law Regime

India has recently witnessed a series of corruption and bribery scandals – from the allocation of telecom licenses and coal blocks to the more recent allegations of kick-backs in a multi-million dollar helicopter procurement contract. This has not only dampened investor sentiment but has also raised questions about India's status as a leading developing economy. One of the reasons most frequently put forward for the level of corruption and bribery in India is its legal and regulatory regime. Some of the key laws date back more than 50 years and have not kept pace with the changing contours of the economy. In addition, enforcement through the court system takes many years and, therefore, is not perceived to act as a deterrent to wrongdoing.

As a result of the constant media attention on corruption and activism displayed by the higher judiciary, the government is taking steps toward reform. One such significant reform, which goes to the core of corporate governance issues, is India's new companies law.

On August 30, 2013, India enacted the Companies Act, 2013[1] (the "New Act"), which has replaced the more than 50-year old Companies Act, 1956. Not all the provisions of the New Act will come into force immediately as a number of them require the Government of India to draft rules and regulations for their implementation. These rules will be drafted in the coming months in consultation with stakeholders.[2]

The New Act is seen as an important step in bringing Indian company law closer to global standards and in improving the ease and efficiency of doing business in India. It touches on areas such as corporate governance, corporate social responsibility, auditor rotation and investor protection, all in an attempt to strengthen internal controls. When the New Act is fully implemented, it will have a direct bearing on the way companies are governed in India – improving corporate governance in a manner that, it is hoped, will reduce misconduct at and by Indian companies. The New Act holds out the possibility of reducing the risk of corrupt practices, although in some ways it also potentially increases such risks in certain respects. The principal risk in this regard arises out of newly mandated Corporate Social Responsibility ("CSR") programs.

The main features of the new law in this regard are set out below.

Corporate Governance and Corporate Social Responsibility

- Public companies will now be required to have independent directors on their boards, with publicly listed companies required to have at least one-third independent directors. Such directors may not be given any stock options and they cannot serve more than two five-year terms. In addition, nominee directors will not be regarded as independent.[3] These provisions are significant as the lack of independent directors and/or their true independent character has always been perceived as a central reason for most corporate frauds. Indian companies are generally promoter controlled and there is no tradition of independent directors challenging the decisions of the promoter. The New Act attempts to remedy this issue.
- The New Act codifies the duties of directors, specifically, the duties to act in good faith, to avoid any direct or indirect conflict of interest with the company, and to exercise due diligence and reasonable care in decision-making.[4]
- CSR will be mandatory for a company with a net worth of INR 500 crores

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1. Notified as Act No. 18 of 2013 in the Gazette of India, Extraordinary, Part II, Section 1, Aug. 30, 2013, http://egazette.nic.in/WriteReadData/2013/E_27_2013_425.pdf.
2. *See* "Govt to Enforce New Companies Bill in Phases," *The Times of India* (Sept. 17, 2013), http://timesofindia.indiatimes.com/business/india-business/Govt-to-enforce-companies-bill-in-phases/articleshow/22643012.cms.
3. Section 149 of the New Act.
4. Section 166 of the New Act.

India Tightens Corporate Governance Norms ■ Continued from page 7

(approximately US$ 90 million) or more, a turnover of INR 1,000 crores (approximately US$ 180 million) or more, or net profits of INR 5 crores (approximately US$ 0.9 million) or more during any financial year. Any company meeting these thresholds will be required to spend annually at least 2% of its average net profits of the preceding three financial years on social and charitable causes.[5] This is a highly innovative provision, but it could also lead to certain forms of bribery in which Indian corporates could be tempted to use CSR spending to benefit politicians in power by conducting CSR activities in their constituencies – a form of indirect lobbying.

Auditor Rotation[6]

- The New Act provides for mandatory auditor rotation for listed and other prescribed companies every five years depending on whether the auditor is an individual or a firm. In addition, there will be a cooling-off period of five years after completion of such a term during which the auditor cannot be re-appointed.
- Approval of the appointment of auditors by the shareholders at every annual general meeting of the company will be made mandatory.
- A company's auditor may not directly or indirectly render any internal audit, investment advisory, management or similar services to the company, its holding company or its subsidiary.
- Further, the auditor will be required immediately to report to the central government upon reasonable suspicion of any offence involving fraud that is being or has been committed against the company by its officers or employees. Presumably, this will include cases in which company funds are being diverted in violation of the company's internal controls for the purpose of making corrupt payments, although the final contours of this auditor reporting duty in specific cases will remain to be seen.

> "[The CSR mandate] is a highly innovative provision, but it could also lead to certain forms of bribery in which Indian corporates could be tempted to use CSR spending to benefit politicians in power[.]"

- These provisions assume great significance in light of certain recent corporate accounting scams like the multi-million dollar Satyam scandal, in which the U.S. Securities and Exchange Commission ("SEC") took action against five Indian affiliates of an international audit firm that served as independent auditors of Satyam Computer Services Limited. The SEC found that the auditors had repeatedly conducted deficient audits of Satyam's financial statements and enabled accounting fraud to go undetected for several years.[7] Although the Indian authorities filed criminal charges against the partners of the audit firms involved, they did not have legislation to regulate auditor conduct – a situation which has now been addressed.

Enforcement

- "Class action" lawsuits will be introduced for the first time in India. The New Act provides that a class of members or depositors, in specified numbers, may initiate proceedings against the company if they are of the opinion that its affairs are being carried out in a manner unfairly prejudicial to the interests of the company, members or depositors.[8] This is seen as a huge step in empowering investors to challenge prejudicial behavior. However, it is hoped that Indian courts will be judicious in entertaining these petitions as this provision could be misused for frivolous litigation.
- Fraud will be made a new ground for seeking the winding up of a company.[9]
- The new law grants additional statutory powers to the government's investigative arm, the Serious Fraud Investigation Office ("SFIO"), to tackle corporate

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5. Section 135 of the New Act.
6. *See generally* Chapter X of the New Act.
7. SEC Press Rel. 2011-82, SEC Charges India-Based Affiliates of PWC for Role in Satyam Accounting Fraud (Apr. 5, 2011), http://www.sec.gov/news/press/2011/2011-82.htm.
8. Section 245 of the New Act.
9. Section 271(1)(e) of the New Act.
10. Sections 211 and 212 of the New Act.

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fraud.[10] It also proposes the establishment of special courts for speedy trials.[11] These measures are an attempt to create an agency similar to the Serious Fraud Office in the United Kingdom, to provide teeth to the Indian government's efforts to tackle serious fraud and corrupt practices. However, what remains to be seen is if true independence and the necessary infrastructure and resources are given to this body.

Although the new law is attempting fundamentally to change the way companies are governed in India, in reality there may be delays before these changes are actually implemented. Nonetheless, despite the fact that other legislation more centrally targeted to bribery, such as the Lokpal Bill (as well as the Whistleblowers Protection Bill), remains stalled in the Indian national legislature, the passage of the New Act is potentially a significant vehicle for positive change as well as a source of potential new burdens and risks.

Among other things, company boards will need to be mindful not only of the risks of mandatory CSR spending, but also the risks posed by mandatory auditor rotation. If a company has had a truly independent, vigorous, and well-staffed independent audit team, the loss of expertise in the manner in which the company operates could have a negative impact. Both audit firms and companies will doubtless be working hard to address these risks.

Please note that Debevoise & Plimpton LLP does not practice or opine on matters of Indian law. This article is based on information that has been published in the press and from other sources in the public domain.

Geoffrey P. Burgess
Christopher K. Tahbaz
Parveet Singh Gandoak

Geoffrey P. Burgess is a partner in the firm's London office and is a member of the Corporate Department. Christopher K. Tahbaz is a partner in the firm's Hong Kong and New York offices and is Co-Chair of Asian Litigation and a member of the firm's Litigation Department. Parveet Singh Gandoak is an associate in the firm's Hong Kong office and a member of the firm's Corporate Department. The authors may be reached at gpburgess@debevoise.com; cktahbaz@debevoise.com, and psgandoak@debevoise.com. Full contact details for each author are available at www.debevoise.com.

11. Section 435 of the New Act.

Latin Lawyer's Anti-Corruption and Investigations Conference

Debevoise & Plimpton and TozziniFreire Advogados, in conjunction with Latin Lawyer, will be hosting a first-of-a-kind conference on anti-corruption compliance in Latin America, on Thursday, October 24, at the Tivoli Hotel in São Paulo, Brazil.

With global enforcement of anti-corruption laws on the rise, companies across Latin America can find themselves subject to complex, invasive and expensive investigations by local and foreign regulators, often with little or no warning. With multiple cross-border legal regimes frequently applicable to Latin American transactions, and, in particular, with Brazil's sweeping new legislation coming into force in January 2014, companies with business in the region are increasingly asking what they should be doing to protect themselves from risks arising under the FCPA, the UK Bribery Act 2010, as well as local laws and even transnational regimes from as far away as China.

Topics to be addressed include:

- The emerging web of anti-corruption laws
- Evolving global enforcement trends
- How to avoid an investigation: compliance best practices
- Limiting corruption risk in M&A
- How to survive a government investigation

Discussions will be led by anti-corruption specialists in government and private practice, including in-house lawyers and compliance officers from some of the world's largest companies. To register, go to http://latinlawyer.com/AntiCorruption2013.

Debevoise & Plimpton LLP Seminars: US/EU Sanctions: Implications for International Banks, Insurers, Private Equity and Other Firms

On Tuesday, 8 October 2013 in Hong Kong, and on Wednesday, 16 October 2013 in London, Debevoise & Plimpton LLP will host seminars on "US/EU Sanctions: Implications for International Banks, Insurers, Private Equity and Other Firms."

United States and European Union economic and trade sanctions have implications for transactions and parties worldwide. United States sanctions regimes – particularly those maintained against Iran – are fast evolving and have global reach; as a consequence, globally based banks and other firms engaged directly or indirectly in transactions with Iran or involving Iranian-origin goods and services may be excluded from U.S. markets and dealings with U.S. firms. European Union sanctions also are becoming wider in application. Recent European Union legislation targets entire sectors, such as the Iranian oil and gas industries, and all those providing ancillary services, including banks, insurers and shippers.

The seminars will review the scope and reach of United States and European Union sanctions and assess their application to and implications for internationally based banks, private equity firms and others. We will review, in detail, those aspects of the sanctions that apply across borders and examine the new U.S. securities law disclosure requirements and how they apply to private equity firms and their portfolio companies. We also will look at recent U.S. enforcement actions that have targeted and penalized non-U.S. banks for failures to comply with U.S. requirements.

Further information about both conferences, including a link to a registration page, can be viewed by clicking here. Alternatively, please email londonevents@debevoise.com or events-hk@debevoise.com if you would like to attend either of these events. Please email sanctions@debevoise.com or call +44 20 7786 5463 if you would like any additional information concerning the firm's sanctions practice.

Upcoming Speaking Engagements and Recent Publications

Upcoming Speaking Engagements

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2013 In-House Congress
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For more information:
http://www.inhousecommunity.com

October 7, 2013
Frederick T. Davis
"Journalism, the Media, and Criminality," IBA Annual Meeting
Boston

For more information:
http://www.int-bar.org

October 8, 2013
E. Drew Dutton
Satish M. Kini
Matthew Getz
Carl Micarelli
Philip Rohlik
"US/EU Sanctions: Implications for International Banks, Insurers, Private Equity and Other Firms"
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Matthew Getz
Jessica Gladstone
Carl Micarelli
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