

Trends, Tips and Lessons Learned

May 2005

International inquiries are steadily increasing. This issue of Trends, Tips and Lessons Learned provides insight into conducting investigations internationally; some interesting observations we have made; and a profile of one of our correspondents in Tokyo.

We also discuss selecting an investigative service provider and some recent investigations that we have conducted.

We very much appreciate your continued business.

Kenneth S. Springer, President
Corporate Resolutions Inc.

Background Check-Ups -- Just Makes Sense

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Many of our hedge fund and private equity clients have us provide them with background updates on the key management personnel every 18 to 24 months. The purpose is to make sure that nothing has transpired since our last report that would be reason for concern or cause a manager to lose focus on the business.

Some of things that could happen are as follows:

1. Divorce proceedings - A divorce can divert a manager's attention away from operating the company. If the divorce is an extremely hostile one, there may be allegations of abuse, which can lead to arrest. If the executive owns a considerable amount of the company, it is feasible that the ex-spouse will own

50% of that after the division of the marital assets. This may be cause for concern and given serious consideration.

2. New business entities - We have found that senior executives have established other business entities, of which the board of directors and/or other management team members may not be aware. In some instances, these new entities are set up to facilitate a hobby in which the executive may be interested. For example, we have had executives set up companies to facilitate their interest in real estate development or in the raising of thoroughbred horses. They can also be set up to divert business

away from the executive's present company, which could be considered fraud or at a minimum a violation of their fiduciary responsibility to the firm. In either scenario, this information should be brought to the attention of the company's board of directors for proper action.

3. Alcohol/Drug Abuse - We have found numerous instances where an executive has been arrested for driving while under the influence of alcohol or drugs. These occurrences could be potentially embarrassing serve as a warning to the company that the executive may have a serious problem.

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Kicking Research Up a Notch

Attorneys contact us to complement their own internal use of paralegals, who are conducting basic Internet, Lexis and West Law searches.

CRI provides a more extensive background check or fact-gathering inquiry to assess or impeach the veracity of a of a witness in arbitra-

tions, depositions and/or related insurance matters. This information proves invaluable in developing a profile of the prospective witness before deposing them. Attorneys also have us interview potential witnesses at the outset in order to document

their version of the incident. If they change their story down the road and end up providing conflicting information, or testifying for the other side, we have them on record as to what they said at the time of the incident.

Troubling Issues Involving CEO's

Investigations conducted during the past 12 months noted a significant increase in troubling situations involving CEO's, ranging from embezzlement to violations of fiduciary responsibilities and breaches of non-compete agreements. CRI was engaged by board members to address these issues.

Prior to commencing our investigation we were retained through the company's outside counsel. In each case, preliminary fact-finding inquiries were conducted in an attempt to determine if the executive had any issues that were readily apparent, i.e., divorce, problems with alcohol or drugs; financial stress, etc. that may be cause for concern. A forensic review of the executive's computer was subsequently conducted. The hard drive was imaged and preserved for evidentiary purposes and the imaged copy was searched for deleted files and emails. Information obtained through that search proved invaluable in several cases, as there was incriminating evidence recovered from the computers. The emails provided insight regarding the activities of the executives that directed the investigation into other areas.

Current and former employees were interviewed and provided information concerning the CEOs of which the boards of directors were not aware. In several cases, the executives had recently changed long established procedures. They would now open and review all incoming mail before distribution to other departments. In one instance, the executive was looking for incoming checks, which he then removed and deposited into an account that he had set up at another bank in a similar name.

The preliminary fact-gathering, determined that several executives had financial problems, which in one instance, was due to a divorce. The computer forensic review uncovered email correspondence, which indicated that several executives had been carrying on an affair for an extended period of time.

The executives that were suspected of defrauding their companies were confronted with the evidence, and each of them admitted to their wrongdoing and all promised to make restitution. The investigation determined however that several executives were highly leveraged and would not be able to reimburse the company for its loss. The companies had insurance for em-

ployee theft. However, in one instance, the loss far exceeded the amount of the insurance coverage. CRI assisted with the preparation of the Proof of Loss, as required by the company's insurance carrier. In each instance, the company was reimbursed by their insurance carrier for the full extent of their coverage, less the deductible. One of the insurance policies also contained a rider that reimbursed the policyholder for a portion of the investigation.

The amounts of the thefts were below the prosecutable thresholds of the federal agencies that had jurisdiction in these matters. The companies had no option other than to present their cases to the local district attorney's office, who often have limited resources to conduct their investigation. They were reliant on the investigation that CRI conducted and used our reports as a critical starting point in their examination.

Several of the companies instituted civil proceedings against their former executives, and CRI is assisting in that litigation process.

A Recent Portfolio Company Investigation

Six months after purchasing a company, the acquired company filed for bankruptcy. The purchaser ultimately sued the big-five accounting firm they hired to conduct the financial due diligence, claiming that their audit was deficient. Suspecting fraud, CRI was retained by the lawyer representing the accounting firm to investigate the incident and determine if there were any irregularities.

Our first order of business was to conduct interviews with both current and former employees. We eventually learned through those interviews that the whole transaction was a set-up. At the time the auditors came in, the company had hired in excess of 60 temporary employees to stand by manufacturing machines that hadn't been operational for over 10 years. The company specifically hired Spanish speaking workers so that the auditors would not be able to ask them any questions. Also, the increase in workers made the business appear to be thriving. Our investigation helped to minimize the liability of the accounting firm inasmuch as we proved that they had been deceived.

Vetting Potential Acquisition Candidates, Fund Managers and Joint Venture Partners

Our international inquiries have increased. We now have 15—20% of our cases being conducted in Europe, Asia, and Latin America. Investors are vetting potential corporate acquisitions, joint venture partners, hedge funds and their fund managers.

Our most recent investigations have taken us to Russia, Turkey, Norway, France, Germany, the United Kingdom, Hong Kong, Japan, and Argentina. Unlike the United States where much of the information is publicly available, we retain “in-country” investigators who gather information through their network of personal

contacts and other sources. The investigators in our vetted network of international correspondents consist of former federal law enforcement agencies, such as the FBI and DEA, and former police and intelligence officers, and in certain countries, especially in Latin America, former military officials.

Are All Investigative Service Providers the Same?

You're all set to make the investment. The company has met all the criteria that you have set out. You have however promised the investors in your new fund that as part of the due diligence, the backgrounds of the company's management team would be checked out. Although you have been in business for years, this is the first time you are faced with doing this. Where do you start and who should you use? Most management teams expect that you will conduct some sort of background investigation of them. How extensive the review and the type of firm you use is your decision.

Most firms can provide you with a public records and internet search. However, if you need to go further in order to resolve a controversial issue uncovered during the review, many of those firms are severely limited. What if the investigation identified a restraining order issued in a domestic dispute or divorce

matter; a sexual harassment complaint filed by a former company employee; a bankruptcy matter, or several undisclosed businesses? Those issues need to be further investigated and resolved prior to closing the deal. You may find yourself in the difficult position of having to ask that person to air their “dirty laundry” to you. Many times, VC's, buyout firms, lenders, and others, are reluctant to ask potentially sensitive and/or personal questions. We have found that if those questions are not asked, subjects do not typically volunteer the information, so it is important to do so. The investigative firm however can act as an intermediary for you, assuming it has the ability and resources to conduct inquiries well beyond background reviews.

We have found that the most expeditious and cost-effective way to get to the bottom of a matter is to interview the subject as part of the due diligence process to resolve issues that surfaced dur-

ing the inquiry. This gives the executive an opportunity to provide their version of what actually happened. There are always two sides of a story, and it is important to hear it from the subject first. Documenting the results of that interview is imperative because if it is found out later that the subject lied, it would provide adequate grounds for dismissing them. If there are still unanswered questions, obtaining copies of available records would help in resolving those questions.

It is very important that you have confidence in the investigative firm's abilities to handle these types of situations, especially if they are interviewing a member of the management team. Please keep in mind that the investigative firm serves as a buffer between the client and the management team member. We have also found that in most instances, it is easier for them to tell a third party and then convey the information to you.

Background Check-Ups -- Just Makes Sense (Cont'd)*(Continued from Page 1)*

4. Financial Stress - We have found instances where the executive has had judgments and/or liens filed against them or, in extreme cases, have filed for personal bankruptcy. Financial problems have been the cause of many executives defrauding their companies.

Any of these issues can be devastating to the executive and to the company that he/she manages. A periodic background check just makes good business sense, no matter how well or how long you have been dealing with an individual.

CRI Trends & News*International*

Some interesting observations:

- In Asia, if you're dealing with any type of manufacturing plant, there is typically an additional company layer that has been formed to get a percentage of the profits produced by the manufacturing firm.
- Secondly, the "old boy network" throughout Europe, Asia, and Latin America is still one of the primary ways to obtain information, as public data sources are not readily available in these locations.

*Profile - Tokyo Correspondent*

CRI's investigative correspondent in Tokyo is a former agent of the Federal Bureau of Investigation, who had extensive investigative experience working on assignments throughout Japan and other Pacific Rim countries. He served as the Deputy Legal Attaché of the U.S. Embassy in Tokyo and had responsibility for criminal, civil and security investigations in Japan, Korea and Taiwan. His previous FBI assignments also included Guam and the Commonwealth of Northern Marianas Islands (CNMI) as the FBI's representative to Micronesia and Palau, along with special assignments to Polynesia, Melanesia, Thailand, Hong Kong, and the Phillipines.

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Corporate Resolutions Inc. (CRI) is a worldwide business investigations and consulting firm, providing a wide range of services to leading financial institutions, the private equity and alternative asset communities, law firms, insurance companies, healthcare organizations and global corporations. CRI, established in 1991, has offices in New York City, Boston and London.

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