

The Continual Challenges of Due Diligence in the Middle East



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In January 2009, the Saudi Arabian Ministry of Interior released a list of 85 designated terrorists of Saudi and Yemeni descent. The list, posted in both English and Arabic on the Ministry website, urged the designated individuals to return to their families and enroll in government-sponsored “rehabilitation” programs, while the Ministry enlisted the help of Interpol to locate and detain the listed subjects. The designation, which came months after the Saudi government indicted 991 suspected Islamic militants, was welcomed by international observers as a concrete signal of the Kingdom’s willingness to cooperate on issues of mutual security. The official acknowledgement of Saudi homegrown militancy, while a sign of progress, also underscores the various challenges and opportunities that remain for companies intent on developing and sustaining business activities in the Middle East.

One overarching challenge faced by Western companies operating in the Middle East is the difficulty in recouping business losses via commercial litigation proceedings. In U.S. courts, for example, the Foreign Sovereign Immunities Act (FSIA) is a frequent mechanism of legal defense that is gaining popularity as governments around the world intervene in private enterprise. *The New York Law Journal* reported on April 13, 2009, that because FSIA immunity is determined at the time a suit is brought (not when the alleged violations occurred), companies will “increasingly find themselves facing firms that were wholly private at the time of the alleged wrongdoing, but in which a government entity later acquired or exercised control.” Consequently, responsible investors should be cognizant of company shareholding structure and senior executive ties to sovereigns, information that is not always readily available for even large Middle East-based businesses. Additionally, with respect to the FSIA, many senior business executives and directors of Gulf Cooperation Council (GCC) companies possess de facto sovereign immunity by virtue of their familial connections to royal family members, or as royals themselves. The 2005 dismissals of leading Saudi royals from lawsuits related to the attacks of September 11 on grounds of sovereign immunity is a high-profile example.

Indeed, Saudi Arabia is a challenging environment for due diligence. Aside from the unavailability of basic public records and difficulty of conducting licensed due diligence activities in a closed Muslim society, recent political developments highlight how the Saudi business environment remains in flux. In February 2009, King Abdullah announced a wide-ranging reform package that was cautiously praised by Western observers. According to *The Economist*, Abdullah’s proposals injected “reformist blood into the ossified school and court systems” by replacing aged officials and reorganizing certain government branches to meet modern service standards. Abdullah announced initiatives to modernize the Kingdom’s courts and even appointed a woman deputy minister (a first) to oversee female primary education. The positive effect for due diligence of this attempt at modernizing the Saudi court system remains to be seen, but it is a welcome sign.

However, in what was seen as a negative development by many U.S.-based analysts, on April 4, 2009, the King appointed his 75-year-old brother, Prince Nayef, as second deputy prime minister and likely successor to the throne. As veteran Saudi watchers are well aware, Prince Nayef has somewhat of an “image problem” in the United States. He is perhaps best known for asserting that “Zionists” perpetrated the attacks of September 11, and has attracted frequent criticisms from international human rights organizations during his 34-year tenure as interior minister for authorizing the brutal and uncompromising tactics of the Kingdom’s internal security forces and notorious religious police. Observers have noted that his potential ascension to the throne, which was characterized as increasingly likely in the wake of his appointment, could prove problematic to U.S.-Saudi relations across the board. Taken together, the recent developments indicate how

the Saudi legal and regulatory environment can be subject to sudden and unexpected changes from the top-down. Such a climate underscores the benefit of maintaining relationships with reliable local partners. This climate can also affect the availability of public information necessary for thorough due diligence inquiries.

Despite widespread reports that the United States and Iran may be abandoning traditional belligerent postures, the Islamic Republic's persistent efforts to undermine international sanctions should remain a source of concern for investors. Indeed, recent judicial proceedings alone underscore the myriad obstacles that remain before diplomatic relations—the necessary precondition for the resumption of widespread commercial activity—can be re-established between Washington and Tehran. Moreover, the legal developments indicate that U.S. authorities remain committed to exposing sanctions violators in the public domain.

In February 2009, veteran Manhattan District Attorney Robert Morgenthau announced criminal charges against Li Fang Wei, a Chinese citizen, and his associated companies. Prosecutors charged Wei with illicitly utilizing Manhattan-based banks to transfer funds to banned Iranian military-run companies. According to the indictment, Wei, who was described as having seven aliases, used a network of Chinese companies to transfer sensitive dual-use metallurgical equipment to entities involved in the Iranian nuclear program. Specifically, prosecutors alleged that Wei—through a firm called LIMMT—sold heavy metals to the Iranian military-controlled Defense Industries Organization from 2006 to 2008, often using shell companies to hide the transactions. Reports noted that Iran requested the transactions be conducted in dollars—the preferred currency of the international arms trade—and Wei allegedly permitted Iranian front companies to launder the funds. Wei's firm, LIMMT, was sanctioned by the U.S. Treasury Department in 2006 for contributing to nuclear proliferation, and added to the Office of Foreign Assets Control's Specially Designated Nationals (SDN) list in April 2009 along with several of its associated subsidiaries. As the Morgenthau charges demonstrate, the discerning lens of the U.S. legal system can be anathema for individuals flouting international norms and Western sanctions.

As security conditions in Iraq continue to improve and countries throughout the GCC remain on the path of regulatory and legal sector modernization, the Middle East will become an increasingly attractive arena for Western businesses. Investors who value their reputations must remain vigilant to ensure the gleaming appeal of future profits does not obscure dark corners of potential risks.



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