"Anti-Corruption Statutes and Legal Ethics"

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Hypothetical 1: Conducting Due Diligence on Potential Acquisition

- Your client, UltraLuxe Hotels, is looking to expand its footprint in Latin America. It has heard rumors that one of the premier hotel chains in the region, *Lujo Hotels*, is potentially on the market. Lujo owns a number of luxury properties, primarily in Mexico and Costa Rica. Its most impressive property—the Lujo Jungle Reserve—is an eco-resort that sits on a highly regulated, protected reserve in Costa Rica.

- UltraLuxe has engaged you to assist with anti-corruption due diligence, but has asked you to "kick the tires generally in case anything else comes up." It wants you to assess whether there are any concerns from an FCPA or local law perspective.

True/False: The FCPA requires the buyer to conduct pre-acquisition due diligence.

False.

While the FCPA does not formally require pre-acquisition due diligence, the Department of Justice and the SEC have explained that they "encourage companies to conduct pre-acquisition due diligence and improve compliance programs and internal controls after acquisition . . ." (Guidance, p. 28) However, there are important reasons to conduct the due diligence nonetheless, including potential successor liability over criminal misconduct. Additionally, for issuers, failure to conduct due diligence under certain circumstances may be deemed an internal controls violation.

- You prepared a detailed due diligence questionnaire and a targeted document request relating to anti-corruption issues. You sent the documents to Lujo's counsel, and have begun to receive the responses.

True/False: If the seller reports that it does not have a robust anti-corruption compliance program, the buyer's counsel should recommend withdrawing from the deal.

False

Not necessarily. The existence of an anti-corruption compliance program is one of the many factors that a potential purchaser must evaluate as part of its anti-corruption due diligence. In particular in the context of small, or family-held companies, it is not uncommon that they will not have formal, anti-corruption compliance programs in place. A potential buyer should continue to ask questions throughout the due diligence process to understand what informal controls may exist in areas such as review and selection of third party vendors.

One of the key goals of due diligence is to identify risks early on, as to lay the foundation for a swift and successful post-acquisition integration into the acquiring company's corporate control and compliance environment.

You reviewed the documents and did not find any documents that reflected an obvious bribery issue. The seller's questionnaire also confirmed that Lujo "had not been the subject of, or ever been involved in, any investigation." Two of the documents that you reviewed seemed interesting. One of them suggests that Lujo Jungle Reserve's environmental impact assessment may have been inadequate, and another document suggests that in 2009 Lujo conducted an internal investigation into potential embezzlement, and concluded that the company had "ineffective controls regarding the use of petty cash."

- You raised both issues with your in-house counsel contact at UltraLuxe, and he told you not to include reference to the documents in your report because neither related to anti-corruption issues. You thought his direction was not entirely unreasonable—even if not the most prudent approach.

Should the documents be included in your report?

A. **Yes, report on both.**
B. **Report on the environmental document but not the petty cash one.**
C. **Report on the petty cash document but not the environmental one.**
D. **Report on neither.**

A. Yes, report on both.

It is often the case that, as part of due diligence on one issue, a buyer uncovers information that is relevant or important to other issues. In this case, even if there is no evidence of bribery per se, the petty cash issue is indicative of gaps in internal controls. The environmental permit issue raises significant questions about the operation of the business

moving forward. Both documents should be highlighted and brought to the attention of the client, as they can both identify significant risks for the company.

Areas for discussion—what potential professional responsibility issues arise in connection with:

- The open mandate to "kick the tires generally"
    - **This could raise an issue under Model Rules 4.1 or 8.4(c). Make sure that by leaving it open what your review is, you aren't misleading about the scope of your work if you don't opine on these two issues.**
    - **As a matter of professional responsibility, an attorney should always define with his or her client the scope of the engagement – including what specific issues the client would like the attorney to evaluate. An attorney risks potential misunderstandings and even liability vis-à-vis the client if the client later alleges that he or she understood that the lawyer was evaluating particular issues, when the lawyer did not believe such issues were under his or her mandate.**
- Being asked to opine on "local law" issues
    - **As a matter of professional responsibility, an attorney may only advise on laws of jurisdictions where he or she is licensed to practice, and on laws on which he or she is competent to opine. This means that any request to opine on "local" law in a foreign country is almost always inappropriate.**
- Following up with regard to the environmental assessment documents
- Following up with regard to the internal investigation report
- Following up with regard to the seemingly inconsistent answer in the due diligence questionnaire
- The exchange with the in-house attorney (e.g., being asked not to document something; a potential duty to escalate issues). **See ABA Model Rule 1.13(b) – For you to escalate it, you'd have to think that (a) not disclosing would violate a law or a legal obligation and (b) not disclosing would be reasonably likely to harm the company. Since (b) isn't met, you don't have a duty under ABA Model Rule 1.13(b) to escalate.**

Hypothetical 2: *The In-House Counsel as a Whistleblower*

- You are now the in-house counsel in connection with the same transaction described previously. Your external counsel has brought the same two documents to your attention—the potential deficiencies in the environmental impact assessment, and the prior investigative report identifying potential embezzlement and internal controls gaps.

- Both documents raise a red flag to you. You ask your lead outside counsel to follow up with the seller—send follow-on due diligence requests, ask for more detailed explanations.

- A week later, your outside counsel writes you the following email:

It's really bad. I think the property hasn't had a valid environmental permit for 10 years. I'm no Costa Rican lawyer, but I think that means the whole property can be shut down by the government. Not sure though. The seller's lawyers at Bill, More & Alot have told me not to worry about it – they can call a guy and get it fixed right away.

On the embezzlement thing – it looks like the former General Manager had been taking a little "bonus" from the house accounts every few months. He was the only one who could sign the house checks, so no one had visibility into what he was doing. I think it's still going on – but the other side isn't giving me any more documents to confirm. Looks like the property owner doesn't know about it.

- You're really concerned now. Not having the environmental permit for the eco-resort could be a major problem. And you are concerned about the suggestion of just "call[ing] a guy and get[ting] it fixed right away?" The embezzlement thing is no better. You decide to call your boss right away.

- Your boss isn't anywhere nearly as troubled as you are. She says, "The seller needs to do whatever they need to do to get the permit thing fixed. We don't own the place yet; not our problem. Plus, you know how things work down there. Whatever it takes as long as they have it by closing." On the embezzlement thing, your boss says, "Listen – if they haven't told the owner, it's their problem, not ours. We'll fire the management company and put in our controls when we acquire it."

- You push back, and say "I really don't agree. We should raise this with the business team – they need to know." Your boss overrules you, and says, "It's not a legal issue; it's a business issue. And besides, this deal has to close right away."

- Unsatisfied with her answer, you think you should escalate it to the board of directors' audit committee.

You consider whether to escalate these issues to your board of directors' audit committee. Should you?

A. **Yes, escalate both issues.**

B. **Escalate only the environmental issue.**

C. **Escalate only the petty cash/internal control issue.**

D. **Escalate neither issue.**

A. Yes, escalate both issues.

In instances in which an attorney feels that another has not given due consideration to, or has improperly dismissed, an important issue that may present significant risks for the company, the attorney should consider escalating the issue through formal channels. The attorney could also consider other avenues – such as consulting with peers within the company (not just his or her supervisor) to get additional input on the potential issue.

Areas for discussion—what potential professional responsibility issues arise in connection with:

- Relying on an external counsel who is not well-acquainted with the relevant area of law. **This is a problem under ABA Model Rule 1.1 – competence. You just can't rely on someone who doesn't know what he or she is doing.**
- The possibility that the seller will do something inappropriate to obtain the environmental permit.
- Telling the property owner about the embezzlement
- The suggestion that issues can be fixed later and that it's not your responsibility if it happened pre-acquisition
- Your boss's comment that "you know how things work down there."
- Issues with raising concerns to the businesspeople, not just the legal team
- Responsibility to raise issues through the compliance hotline

Escalating these is probably not required under ABA Model Rule 1.13(b). Because the company isn't the one violating the law, then 1.13(b)'s first condition doesn't kick in. Though it may really be a good idea for other reasons.

Hypothetical 3: "But it's urgent!" – The Pushy General Manager

- You're an in-house counsel at a U.S. based-international hotel chain, which has been listed on the New York Stock Exchange since 1999.

- Your company's most profitable managed property is in Macau, China—one of the gambling capitals of the world. You know that Macau is a high-risk market for corruption issues, and you're prepared. You do periodic audits, conduct extensive compliance training, and have two compliance officers in the region focusing just on China. You pay special attention to areas that you know are potentially risky, such as junket trips for high-rollers, tax audits, and casino licensing.

- One day, you get a call from the compliance assistant in the region. It's the week before the Chinese New Year—one of the busiest times for the hotel— and a local government official has showed up to the hotel for a "surprise inspection of the casino." The compliance assistant had never heard of such an inspection, and the General Manager is quite concerned.

- You call the General Manager immediately and ask for more information about the inspection. The GM replies: "This is an urgent situation for us. We're at 100% capacity the next few days; we can't have them shut down the casino." You explain that "you should cooperate with the inspection, and ask for documentation of any issues. I will contact our local lawyer in China to go to the hotel and be there for the inspection."

- When you call him back, the GM tells you: "I spoke to the inspector and showed him the records he wanted to see. He said everything was fine, but that we had been late on getting a particular permit. He said we had to pay a US$1,000 penalty." The GM further explained that "I didn't think we actually needed the permit he discussed, but I wasn't going to risk it for such a low amount of money, so we paid it. Do you need me to document that somewhere?"

True / False: You need him to document that somewhere.

True.

The FCPA requires that issuers' books and records are accurate. Any payments made to government officials must be documented.

Areas for discussion—what potential professional responsibility issues arise in connection with:

- The advice that "you should cooperate with the inspection"

- Reporting the conduct up or out (e.g., does it change because you're publicly traded)

- Responsibility to investigate or follow up on the nature of the alleged permit

Hypothetical 4: The Government Official/Owner

- You are the in-house attorney for the management company that runs a luxury hotel in the Kingdom of Genovia. A member of the Genovian Royal Family owns the tower, but your company manages the property.

True/False: The FCPA prohibits entering into business transactions with foreign government officials.

False

The FCPA does not prohibit conducting private business transactions with foreign government officials. Indeed, this comes up rather frequently. For instance, a company might hire a public university professor to serve as a consultant, or to conduct research on a company product. Similarly, in some countries, such as China, entire industries are controlled or owned by the State. As such, conducting business will necessarily require entering into business relationships with foreign government officials. The prohibited conduct is providing something of value to the government official *with the corrupt intent* of obtaining some official, favorable action by the official (the "quid pro quo").

- A standard clause of the management agreement is that the property owner may use a standard suite for up to two weeks a year, free of charge. During the owners' stay, the hotel also provides unlimited food and beverage service. You and the rest of the legal and compliance team were careful to ensure that—given the Royal Family ownership issue—the owners of the hotel tower would receive exactly the same as other properties' owners—no more, no less.

True/False: If the benefits offered are provided for in a hotel management agreement approved by a more senior government official, the benefit would likely not violate the FCPA.

True.

This would likely not violate the FCPA for two reasons. First, having appropriate approval by a more senior government official likely obviates any corrupt intent. Second, the FCPA has an affirmative defense for benefits that are pursuant to the "execution or performance of a contract with a foreign government or agency thereof."

True / False: <u>Now assume that a state-owned entity owns the hotel</u>. If the benefits offered are provided for in a hotel management agreement approved by a more senior government official, the benefit would likely not violate the FCPA.

True

This owner of the hotel would not change the analysis.

- This year, the Royal Family member has asked to stay for three weeks, and be upgraded to the Supreme Suite—your most luxurious, two-level suite.

- The property's General Manager agrees to the request because, even though the hotel is quite busy that week—and the room could have sold for a lot of money—he understands that the Royal Family member is planning on building a new tower nearby, and it would be a good business opportunity to try to sign a management agreement for that tower too. The GM asked the Finance Manager to register the transaction on the books as 2 weeks at the basic suite price, with the difference in cost logged to a "business development" account—and the entire final week logged to that account as well.

- At your annual regional retreat, the Finance Manager casually mentions the issue during a dinner.

Areas for discussion—what potential professional responsibility issues arise in connection with:

- Obligation to investigate potential issues.

Hypothetical 5: Investigating at a Managed Property

- You decide to conduct a brief internal investigation to understand what really happened with the Royal Family member at the hotel. The owner isn't thrilled about it, but you repeatedly explain that, as a U.S. company conducting business abroad, you have a responsibility to investigate any concerns.

- Even though the Royal Family owns the tower, the hotel's employees are yours as the management company. So, as usual, you issue a document hold, collect relevant emails, develop an investigation plan, and schedule interviews with hotel employees.

- *Potential True/False:* A company may interview another company's employees as part of an investigation and assert privilege over such interview. You conduct your interviews and take extensive notes. The interviewees are all clear about what happened. They described in detail the Royal Family member's stay, the expenses they incurred, the parties they held, and how the expenses were registered on the hotel's books. One of your key interviews was with the GM—who admitted that he had approved the whole stay as a token of goodwill with the Royal Family member. He said: "The Royal wasn't acting as a government official. He is just our business partner—the owner of the building—who happens to be a government official. But I wasn't asking for any official government action in exchange for the stay. I was looking to do private business with him in the future."

- The Royal Family member knows you've finished your work and asks for a call to discuss your findings.

True/False: You may safely share this information with the hotel owner.

False.

As a general matter, you may not share this information with the property owner, as described in the hypothetical. Your client is the hotel management company, not the owner. Your duty of confidentiality and the attorney-client privilege runs to the management company. They get to decide if, and what, information should be shared with the owner. In this case, it would be especially problematic to share information without consulting with your client because the property owner is one of the targets or interested parties in the investigation.

Areas for discussion—what potential professional responsibility issues arise in connection with:

- Who gets to claim privilege over the interviews or materials.

- Can you share information with the putative target.