Ethical Considerations in Business Transactions

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SECTION 01

SOURCES OF ETHICAL OBLIGATIONS
Select Sources of Ethical Obligations

- ABA Model Rules of Professional Conduct
- New York Rules of Professional Conduct
- New York Business and Professions Code
- Corporate Policies and Code of Conduct (including antitrust compliance programs)
- Securities laws
- Sarbanes-Oxley Act
- Other laws, rules and regulations
SECTION 02

ETHICS IN M&A TRANSACTIONS
Ethics in M&A Transactions

- Confidentiality Agreement
- Letters of Intent
- Due Diligence
  - Communication of issues to boards of directors/management
  - Disclosure of problems that could impact the transaction
- Definitive Documentation
  - Negotiations
  - Drafting Issues
- Closing
- Post-Closing Relationships
A Lawyer’s Responsibilities - Scope

• Acting in a dual capacity
  – Cannot hide behind another title or a business role in the deal

• Managing the business people / bankers’ role and activities
  – Lawyers should ensure ethical behavior from other representatives of the company

• Ensuring the lawyer does not direct a client to conduct activity that the lawyer is prohibited from conducting
  – Statements made to other parties in negotiations
  – Engaging with counterparties
SECTION 03
IDENTIFICATION OF CLIENT AND CONFLICTS OF INTEREST
Conflicts of Interest - Identification of the Client

- Boss vs. client
- The transaction is not the client
- Corporation/entity vs. officers/shareholders
- Joint venture vs. members
- When management are also shareholders/owners
- Management of transaction counsel dealing with differing owners/shareholders (and their differing interests)
- Be cognizant of relationships and potential conflicts
- Selling subsidiaries and spin-offs with different management
- Restructurings and bankruptcies – board of directors vs. management vs. equity holders vs. other interest holders
Conflicts of Interest – Change of Control

• Management Issues
  – Outside counsel has pre-existing relationship with management
  – Management focusing on its incentive compensation/buyouts
  – Counsel instructed to accept more risk for better deal for management

• Stock Sales / Spin-offs
  – Majority stockholders vs minority stockholders
  – Outside counsel has relationship with significant shareholder and represents such shareholder in other transactions
  – Outside counsel focused on "retaining" subsidiary as a client post-transaction
  – Disputes between parties after the transaction

• Mergers
  – Joint representation of company and selling stockholders
  – Attorney-client representation passes to new owners of a business
  – Treatment of pre-transaction privileged information
SECTION 04

COMMUNICATION WITH OPPOSING PARTY
Communication Without Going Through Opposing Counsel’s Lawyer

ABA Model Rules of Professional Conduct 4.2
In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.
Communications – Opposing Party

- Adversarial process
- Sophistication level of counterparty
- Unrepresented by counsel
  - ABA Model Rule 4.3 - The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.
    - No indirect circumvention
    - Communicate with other counsel
Lawyer is representing Martin Corp. in an acquisition of a division of MacAvoy Corp. The parties are agreed on most points, but have come to an impasse on whether MacAvoy should retain certain pension liabilities of the division. Martin's CEO wants to get the deal signed today because tomorrow morning he is taking the company jet to the Augusta National, where he will not be permitted to use his cell phone. MacAvoy's lawyer is in the hospital for a minor procedure, and is expected to be available in a few days.

Lawyer suggests that the Martin CEO give the MacAvoy CEO a call to hammer out the point.

*Question:*
Can Lawyer have the two CEOs negotiate the pension liability issue?
Communications – Hypothetical

*Answer:*

If it would be an ethical violation for a lawyer to contact that party, the lawyer cannot circumvent the ethics rules by having a non-lawyer contact the third party.

However, even if the parties to a matter are represented by counsel, they have a right to communicate with one another, and the lawyer may provide advice regarding the communications the client is legally entitled to make.
Communications – Opposing Party

• ABA Model Rule of Professional Conduct 8.4
  – It is professional misconduct for a lawyer to:
    • violate or attempt to violate the Rules of Professional Conduct;
    • knowingly assist or induce another to do so; or
    • do so through the acts of another.
Reading the Other Side’s Misdirected Communication - Hypothetical

Through the "auto-complete" function of email, Seller unintentionally emailed Buyer’s Lawyer a document intended for Seller’s Counsel regarding the status of a significant negotiation point between the parties. Buyer’s Lawyer takes swift action to make Seller aware of the misdirected communication and return the confidential documents. During the course of continued negotiations, Seller continued with their negotiating position even though the confidential information had been returned.

*Question:*

Does Buyer’s Lawyer have an ethical obligation to refrain from disclosing the confidential information to Buyer?
Slowing the Conveyance of Information

ABA Model Rules of Professional Conduct

"A lawyer who receives a document or electronically stored information relating to the representation of the lawyer's client and knows or reasonably should know that the document or electronically stored information was inadvertently sent shall promptly notify the sender." (Rule 4.4(b))

ABA formally withdrew prior Formal Opinions imposing additional obligations on the recipients of such information. The only obligation under Model Rule 4.4(b) is to notify the sender.
Reading the Other Side’s Misdirected Communication - Hypothetical

Answer:

• Given the ABA Model Rules, the Buyer's Lawyer may discuss with his/her client, as the negligence of the one side should not disable the effectiveness of advocacy of the lawyer who knows that there has been a misrepresentation made to her client.
Undisclosed Recording of Telephone Conversations

- **Federal Law**
  - Recording of a telephone conversation by a non-law enforcement individual is permitted with the consent of at least one party to the conversation.
SECTION 05

SELECTED TRANSACTIONAL ISSUES

• CONFIDENTIALITY AGREEMENTS
Confidentiality Agreements

- Purpose of confidentiality and non-disclosure agreements
- Good Faith/Bad Faith
  - “Fishing expeditions”
  - Process for destruction/return of confidential documentation
- How to handle violations of confidentiality agreements
  - Honest errors
  - Blatant violations
- Impact of violations on deal process and communication
- Enforcement and lack of policing of ongoing obligations
SECTION 05

SELECTED TRANSACTIONAL ISSUES

• AUCTION CONSIDERATIONS
Auctions – Multiple Bidders

• Collusion among bidders?
  – Violations of confidentiality and non-disclosure agreements
  – Joint bids - Antitrust considerations

• Failures to adhere to auction process guidelines
  – Overbidding to get into next round when there is no intention of keeping price static
Auctions – Unethical Sellers

- Communicating with other bidders
- Inflated pricing?
- Withholding crucial diligence information till after bid proposals submitted
  - Requiring full mark-ups of agreements when diligence is in initial stages
- Failure to hold bidders to auction process
  - Ethical bidder disadvantaged
  - Bidders incur costs/expenses without any real opportunity to participate in the process
SECTION 05

SELECTED TRANSACTIONAL ISSUES

• NEGOTIATIONS
Lawyer’s Role as Negotiator

ABA Model Rules of Professional Conduct

“As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirement of honest dealings with others.”
Lawyer’s Role as Negotiator – Misrepresentations

- **Puffery**
  - "Puffery" (the exaggeration or overemphasis of certain facts in an attempt to gain a bargaining advantage) is permitted, but untrue statements are not

- **False Statements**
  - Lawyer must not "knowingly" make a false statement of material fact or law to a third person
    - The definition of "knowingly" requires actual knowledge of truth or falsity, as opposed to uncertainty or even suspicion of possible falsity
    - "Knowledge" can be inferred from circumstances
    - Federal sentencing guidelines provide that a person was willfully ignorant of an offense if the individual did not investigate the possible occurrence of unlawful conduct despite knowledge of circumstances that would lead a reasonable person to investigate whether unlawful conduct had occurred

- **Omissions**
  - Misrepresentations as a result of omissions are prohibited
  - Truthfulness vs. doing the other side’s diligence
Lawyer’s Role as Negotiator - Hypothetical

 Answers:

- “There may be other bidders for Seller” – **YES**, this statement is permissible
- “There are multiple other bidders for Seller” – **NO**, this statement is NOT permissible
- “Other offers are expected any day now” – **YES**, this statement is permissible
- “Bidder is considering another offer” – **NO**, this statement is NOT permissible
Conflicts of Interest – Fraud Hypothetical

Seller is selling a subsidiary, Newco LLC. Seller and its Lawyer know that Newco LLC has engaged in accounting fraud. Seller has not yet revised or made adjustments to the accounting statements of Newco, but in the sale process discloses all information necessary to "uncover" Newco's fraud by potential purchasers.

Question:
Is Seller aiding and abetting Newco’s fraud?
Conflicts of Interest – Fraud Hypothetical

*Answer:* If lawyer knows of fraud, ethical and legal obligations may require reporting:

- Reckless disregard for the truth
- Duty of candor
- Fraud: Misrepresentation/concealment of material fact, reliance, and harm to the victim
- Successor liability
- Ongoing fraud
- Consider other legal issues the fraud raises (whistleblower, 10b-5, etc.)
- Consider risk created for client seller by not outright disclosing the fraud to the buyer
SECTION 05

SELECTED TRANSACTIONAL ISSUES

• TECHNOLOGY
Special Ethical Issues with Personal Technology Use

• **Mobile Devices**
  - Transmission of confidential information to personal devices, email, storage facilities.
  - Ethical rules and contractual obligations

• **Cloud Computing**
  - Storage must be secure, from a reputable vendor

• **Social Media**
  - Ensure your own messaging is honest, with little puffery and no misstatements of material fact
  - Sharing and posting must comply with confidentiality rules
SECTION 06

BEST PRACTICES
Best Practices

- Transaction post-mortems
- Adoption of compliance programs
- Internal investigations in transactions with ethical issues
- Disclosure of risks to the board of directors
  - Issues to elevate and in-house counsel’s duty to elevate