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FCPA Update

A Global Anti-Corruption Newsletter

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Impact of EU General Data Protection Regulation on Corporate Investigations and Due Diligence

The EU General Data Protection Regulation ("GDPR"), which took effect May 25, 2018,[1] has led companies to re-evaluate how they handle personal data, including in connection with investigations and due diligence exercises. If interpreted strictly, some of the GDPR's requirements could conflict with companies' internal goals and with the expectations of prosecutors and regulators in the white-collar realm. The magnitude and implications of that conflict are the subjects of wide-ranging debate.

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1. Regulation (EU) 2016/679 of the European Parliament and of the Council, of April 27, 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC ("General Data Protection Regulation"). GDPR applies in the 28 EU Member States and the three countries in the European Economic Area that are not in the EU (Iceland, Liechtenstein and Norway). This article uses "EU" as shorthand for all 31 countries.

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The GDPR's broad scope and the lack of prior enforcement or interpretive guidance for many of its provisions have led to substantial uncertainty and concern in numerous areas of corporate life. The concerns expressed are warranted, and additional guidance from the EU data protection authorities ("DPAs") on how they will interpret and enforce the GDPR is needed. That said, some of the worst fears about GDPR's clash with white-collar investigations may be overblown. We are cautiously optimistic that, with the right procedures and careful strategic thinking about competing considerations, companies can stay on the right side of both white-collar and data privacy authorities in the European Union, the United States, and elsewhere. In this article, we explore these issues in the white-collar and compliance context.

GDPR and Due Diligence Checks

Most anti-bribery laws require, or related guidance strongly recommends, that companies carry out due diligence and conduct background checks on third parties with which they do business. This is a central aspect of any anti-corruption compliance program. Without it, a company is unlikely to successfully argue that it has instituted adequate procedures under the UK Bribery Act or that it should qualify for a fine reduction or a declination in an enforcement action pursuant to the U.S. Foreign Corrupt Practices Act ("FCPA").

The heart of the GDPR is the requirement that any processing of personal data must fall within one or more of the enumerated legal bases.[2] Both "personal data" and "processing" are defined in broad terms; a due diligence exercise or a background check almost certainly involves both. Generally, personal data processing in the due diligence or background check context is likely to fall within one or both of the following:

- it is required by applicable EU or Member State law; and/or
- it is in the company's legitimate interest and is determined not to unduly impinge upon the interests or fundamental rights of those whose personal data is processed.

Article 10 of the GDPR further restricts processing of personal data relating to criminal convictions and offences, prohibiting it unless it is authorized by EU or Member State law. Thus, if a due diligence exercise or a background check involving criminal history information is conducted in the EU, or is otherwise subject to the GDPR,[3] companies would need to rely on EU or Member State law that permits such personal data processing.

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2. *See* GDPR Article 6.
3. For a brief explanation of GDPR's extraterritorial scope, *see* Debevoise Debrief, "GDPR: Should I Care?" (May 14, 2018), https://www.debevoise.com/~/media/files/insights/publications/2018/05/20180511_gdpr_should_i_care%20(2).pdf.

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Several EU Member States have adopted exemptions from Article 10 in their domestic legislation. For example, the UK Data Protection Act 2018 ("DPA 2018")[4] permits companies to process data covered by Article 10 for a number of purposes, including compliance with regulatory requirements, prevention of unlawful acts in some cases, or to obtain legal advice.

Where Member State law does not specify how GDPR Article 10 applies, it can be viewed as requiring exclusion of criminal checks from the due diligence process. In our view, such a conclusion, while possible upon literal reading of the law, would run contrary to the intention of the GDPR as well as other EU and Member State laws. For instance, the Fourth Money Laundering Directive (EU) 2015/849 requires companies to carry out customer due diligence appropriate to the money laundering risks the customer presents when establishing or maintaining a business relationship. Companies established or operating in the UK could also be liable under the UK Bribery Act for failure to prevent bribery if they cannot demonstrate they applied adequate due diligence procedures to mitigate bribery risks.

> "The GDPR's broad scope and the lack of prior enforcement or interpretive guidance for many of its provisions have led to substantial uncertainty and concern in numerous areas of corporate life. . . . [A]dditional guidance from the EU data protection authorities on how they will interpret and enforce the GDPR is needed."

A company that is conducting due diligence in line with its legal or regulatory requirements, or even guidance or recommendations of competent authorities, could reasonably argue that it satisfies GDPR's requirements even if its due diligence includes criminal history information. We believe it is unlikely, though not impossible, that Member State DPAs, which will enforce the GDPR, would use their enforcement powers to go after companies that conduct due diligence checks in good faith to ensure compliance and prevent fraud or other unlawful acts.

GDPR and Document Production to U.S. Authorities

GDPR's enactment has renewed the debate around the cross-border transfer of personal data from the EU to the United States for the purposes of its production to U.S. authorities. Such data transfers may be called for on a compulsory basis,

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4. Data Protection Act 2018 *(c.12)*, dated May 23, 2018, http://www.legislation.gov.uk/ukpga/2018/12/contents/enacted.

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e.g. in response to subpoenas or document requests, or on a voluntary basis to obtain cooperation credit or to facilitate a U.S.-led internal investigation. The GDPR did not substantially change the cross-border data transfer regime; Chapter V of the GDPR is virtually identical to Chapter IV of the EU Directive 95/46/EC,[5] which dealt with cross-border transfers. That said, GDPR brings a dramatic increase in potential fines, as well as increased awareness about data protection issues more generally. The cross-border transfer conundrum, which has long plagued multinational companies, thus has resurfaced.

Internal Investigations

For investigations of suspected misconduct that are purely internal, where data is transferred between the EU and U.S. divisions or affiliates of the same company (or between the company and its legal or other advisers), the cross-border transfer of personal data often can be effected by adopting what GDPR refers to as "appropriate safeguards."[6] This is a list of measures, pre-approved by EU authorities, whereby the data importer makes a binding commitment to treat the imported data according to EU privacy standards.

A particularly useful "appropriate safeguard" in internal investigations is Standard Contractual Clauses ("SCCs"),[7] which can be signed among the entities involved.[8] SCCs are provisions, ratified by the European Commission, that require the non-EU-based data importer to comply with a number of obligations with respect to its treatment of personal data received pursuant to the SCCs. The SCCs also restrict onward transfers from the data importers to third parties.

Government Investigations

Intracompany SCCs, or those between the company and its advisers, are of limited use to companies seeking to transfer personal data to U.S. government authorities, which are unlikely to sign the SCCs. When SCCs or other appropriate safeguards are not available, the GDPR provides a list of so-called "derogations."[9] Derogations are exceptions that, in specified circumstances, allow for the transfer of personal data from the EU to the United States in the absence of the SCCs or other appropriate safeguards.

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5. Directive 95/46/EC of the European Parliament and of the Council, dated October 24, 1995, on the protection of individuals with regard to the processing of personal data and on the free movement of such data.
6. GDPR Article 46.
7. Commission Decision 2010/87/EU, dated February 5, 2010 on standard contractual clauses for the transfer of personal data to processors established in third countries under Directive 95/46/EC of the European Parliament and of the Council.
8. The now-replaced UK Data Protection Act 1998 permitted cross-border transfers "necessary for the purpose of obtaining legal advice" in the absence of SCCs. Neither the GDPR nor the DPA 2018 includes this provision, likely necessitating the use of SCCs in some cases for transfers of personal data from UK-based clients to their U.S.-based counsel.
9. *See* GDPR Article 49.

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For the purposes of white collar matters, the most helpful derogation is likely GDPR Article 49(1)(e), which allows for cross-border transfer of personal data when such transfer "is necessary for the establishment, exercise or defence of legal claims." This derogation, which also applied under the pre-GDPR regime, was sometimes narrowly interpreted by practitioners to apply only when an adversarial legal proceeding was under way. Recent guidance issued by Working Party 29 ("WP29"), a coalition of EU Member States' DPAs, is more expansive.[10]

The guidance provides that the Article 49(1)(e) derogation would apply when data is transferred for the purposes of a non-EU criminal or administrative investigation or to obtain a "reduction or waiver of a fine legally foreseen." The guidance specifically calls out non-EU antitrust, corruption, and insider trading cases as examples. As such, companies may be able to rely on this derogation to produce data to the U.S. Department of Justice or the U.S. Securities and Exchange Commission in connection with FCPA and other white collar matters. The guidance cautions that the transfer must be made pursuant to a "formal, legally defined process" and be necessary for the legal claim. The U.S. authorities' "mere interest" in the data or the company's desire to earn possible "good will" with the U.S. authorities would not be a sufficient basis for the data transfer.

The guidance suggests that, if the U.S. authorities have opened an investigation into the company and requested documents, the company may be able to produce certain documents containing personal data from the EU without violating the GDPR. That is arguably so even if the information is produced in response to a voluntary request of the U.S. authorities.

Where a particular issue is not under investigation in the United States but the company decides to voluntarily self-disclose it to U.S. authorities, the analysis is more difficult. Although much would depend on the circumstances of a particular case, it may be hard to argue that such voluntary self-disclosure constitutes an attempt to "reduc[e] or waive[] a fine legally foreseen." It is more likely to be characterized as a wish by the company to gain goodwill with the U.S. authorities, which is insufficient under the GDPR as it has been interpreted thus far. In this scenario, companies may want to consider limiting or eliminating personal data from the initial disclosures to the U.S. authorities, producing such information only if an express and formal request for it is made.

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10. Guidelines on Article 49 of Regulation 2016/679, dated February 6, 2018, http://ec.europa.eu/newsroom/article29/document.cfm?doc_id=49846. In May 2018,WP29 was replaced by the new European Data Protection Board, likewise a coalition of DPAs. Prior WP29 guidance remains valid.

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There also may be limited scope for transferring personal data to the United States on the basis that doing so serves "important reasons of public interest" pursuant to GDPR Article 49(1)(d). The WP29 has interpreted this derogation narrowly. According to its guidance, to fall within this derogation, the data transfer must be in the public interest of the EU or the EU Member State in which the data exporter is based. The guidance suggests that a transfer made in connection with an investigation by U.S. authorities would not be in the public interest of the EU even if the investigation furthers shared interests like combatting terrorism or money laundering.

This restrictive view of the public interest derogation appears to have been contradicted by the European Commission in a somewhat different context – the Commission's amicus brief to the U.S. Supreme Court in *United States v. Microsoft*.[11] In the brief, the European Commission suggested that the public interest derogation may serve as a basis for personal data transfer from the EU to the United States where shared interests are at stake. The Commission recognized "the fight against serious crime – and thus criminal law enforcement and international cooperation in that respect – as an objective of general interest" that is potentially sufficient to meet the public interest derogation requirements. If the view stated by the Commission in its brief prevails, GDPR Article 49(1)(d) may serve as another basis for transferring EU personal data to U.S. authorities.

GDPR and Interviews

The GDPR's transparency principle requires that individuals receive extensive information about how their data will be processed and with whom it will be shared. That disclosure must be made before personal information is collected.

Interviews with company employees or third parties conducted in the course of white collar investigations almost certainly involve collection and processing of personal data about those individuals. Companies need to consider what, if any, additional information should be provided to the interviewees when the interviews are subject to the GDPR. Some of the information required by the GDPR is already routinely provided to the interviewees, including that the information gathered in the course of the interview would be shared with the client of the lawyer conducting the interview (usually the company) as well as, potentially, third parties including government authorities. In some cases, additional information may be provided in data collection notices that the interviewees receive prior to the interviews.

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11. Brief of the European Commission on behalf of the European Union, *United States v. Microsoft*, https://www.supremecourt.gov/DocketPDF/17/17-2/23655/20171213123137791_17-2%20ac%20European%20Commission%20for%20filing.pdf. For additional information on the U.S. CLOUD Act, which mooted the *Microsoft* case, see Debevoise Update, "Cloudy with a Chance of Clearing: U.S. CLOUD Act and European Response" (May 8, 2018), https://www.debevoise.com/~/media/files/insights/publications/2018/05/20180507_cloudy_with_a_chance_of_clearing_u_s_cloud_act_and_european_response_2.pdf.

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Other information that Article 13 of the GDPR requires to be provided to the data subjects – how long the personal data would be stored and the data subject's rights to access, rectification, and erasure of personal data – is less likely to be part of a standard investigative interview process. Companies should consider whether and how to provide this additional information. To avoid overly lengthy and legalistic interview introductions, it could be included in a written notice ahead of the interview (such as the interview invitation itself).

"The GDPR's transparency principle requires that individuals receive extensive information about how their data will be processed and with whom it will be shared. That disclosure must be made before personal information is collected."

In some EU Member States, domestic law may provide relevant exceptions to GDPR Article 13. Under the DPA 2018, for example, Article 13 information need not be disclosed to the data subject if legal professional privilege applies to the personal data at issue.[12] In other words, if the interview and its contents are covered by legal privilege in the UK, the interviewer need not provide a special GDPR disclosure to the interviewee. Unfortunately, recent UK court decisions have cast doubt on the applicability of UK legal privilege to investigative interviews and records of those interviews.[13] As such, the scope of this GDPR exception is tied up with the uncertainty relating to the status of legal privilege in investigations.

Conclusion

Given the GDPR's broad scope, lack of enforcement history, and limited guidance from DPAs, a great deal of uncertainty over the GDPR's impact on investigations and due diligence remains, and may be with us for some time. That need not and should not stop investigations or due diligence in their tracks. Rather, careful consideration

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12. Data Protection Act 2018, Schedule 2 Part 4.

13. *See* Debevoise Client Update, "English High Court Considers Status of Internal Investigation Interview Notes," (Apr. 25, 2018), https://www.debevoise.com/insights/publications/2018/04/english-high-court-considers-status; *see also* Debevoise Client Update, "Litigation Privilege in UK Internal Investigations Revived?" (Feb. 13, 2018), https://www.debevoise.com/insights/publications/2018/02/litigation-privilege-internal-investigations.

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of applicable legal requirements by experienced counsel can help companies reduce their risks of GDPR non-compliance while furthering their objectives.

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DOJ Applies Expansive Theory of Agency in Legg Mason Enforcement Action

On June 4, 2018, the U.S. Department of Justice entered into a non-prosecution agreement with Legg Mason, Inc., a Baltimore-headquartered investment management firm (the "NPA" or "Legg Mason NPA").[1] In order to resolve the DOJ's investigation, Legg Mason agreed to pay a criminal penalty of $32.6 million as well as disgorgement of $31.6 million to be paid within one year and to be set off against any disgorgement paid to other agencies. Legg Mason's 10-K filed on May 30, 2018, appears to indicate that the disgorgement amount is intended ultimately for a settlement with the U.S. Securities and Exchange Commission.[2]

The NPA was one of two related FCPA resolutions entered into on the same day involving improper payments to Gaddafi-era Libyan officials by investment funds (the other, as noted below, was with Société Générale). In addition to the 2016 DPA with Och-Ziff,[3] there have now been three Libya-related resolutions, and the NPA discloses that "at least eight U.S.-based financial institutions" sought placements from Libyan state agencies in during the period 2005 to 2011, suggesting additional resolutions may follow. The Libya-related FCPA resolutions, like the SEC's unrelated resolution with BNY Mellon in 2015,[4] highlight the risks involved in dealing with sovereign wealth funds in countries with significant corruption risks.

The Legg Mason NPA also is noteworthy in that it assigns criminal liability to the corporate parent even though all of the wrongdoing allegedly took place at the level of a subsidiary. In this respect, as discussed below, the NPA reflects an expansive application of the agency theory of liability and little regard for the principle of corporate limited liability (here, with respect to a parent's liability for the acts of a subsidiary).

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1. Letter to John F. Savarese re: Legg Mason Criminal Investigation (June 4, 2018); Department of Justice Press Release No. 18-725, "Legg Mason Inc. Agrees to Pay $64 Million in Criminal Penalties and Disgorgement to Resolve FCPA Charges Related to Bribery of Gaddafi-Era Libyan Officials" (June 4, 2018), https://www.justice.gov/opa/pr/legg-mason-inc-agrees-pay-64-million-criminal-penalties-and-disgorgement-resolve-fcpa-charges ("Legg Mason NPA").
2. Legg Mason stated in its 10-K that it would "shortly complete negotiations with both the U.S. Department of Justice and the SEC staff to resolve a Foreign Corrupt Practices Act investigation … we have accrued a $67 million charge to earnings for this matter in the year ended March 31, 2018, representing our current estimated liability for the settlement of the matter." https://www.sec.gov/Archives/edgar/data/704051/000070405118000066/lm_10kx3312018.htm.
3. *United States v. Och-Ziff Capital Management Group LLC*, Deferred Prosecution Agreement, Cr. No. 16-516 (E.D.N.Y. Sept. 29, 2016), https://www.justice.gov/criminal-fraud/fcpa/cases/och-ziff-capital-management-group-llc.
4. SEC Press Rel. 2015-170, "SEC Charges BNY Mellon With FCPA Violations" (Aug. 18, 2015), https://www.sec.gov/news/pressrelease/2015-170.html.

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The Legg Mason NPA

According to the statement of facts stipulated as part of the NPA, Legg Mason's asset management subsidiary (initially majority-owned, then wholly-owned), Permal Group Ltd. ("Permal"),[5] sought investments from the Libyan Investment Authority and other Libyan state agencies after the lifting of economic sanctions in 2005.[6] Two Permal employees conspired with employees of Société Générale[7] to pay a Libyan intermediary (through a Panamanian company) and to a Dubai banker in order to encourage investments by Libyan state agencies.[8] Some of these funds were subsequently paid to various Libyan officials linked to the Gaddafi Regime. The Permal employees established the initial relationship with the Libyan intermediary in 2004.[9] Although the Permal employees sought direct investments from the Libyan state agencies, the Libyan state agencies actually bought notes from Société Générale. These notes were linked, in part, to the performance of funds managed by Permal.[10]

The NPA is explicit that neither Legg Mason nor its employees were involved in the scheme to make payments to Libyan officials. Categorized as a mitigating factor, the NPA states that "the misconduct … involved only two mid-to-lower level employees of [Permal] and was not pervasive throughout [Legg Mason]."[11] Permal appears to have been dissolved in 2016, when "its interests in the asset management businesses were contributed to a new entity."[12]

Agency Law, Corporate Limited Liability, and the FCPA

The doctrine of corporate limited liability is one of the most basic principles of American corporate law. As the Supreme Court stated in *United States v. Bestfoods*, "[i]t is a general principle of corporate law deeply ingrained in our economic and legal systems that a parent corporation (so-called because of control through ownership of another corporation's stock) is not liable for the acts of its subsidiaries."[13]

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5. Legg Mason NPA, Attachment A at ¶ 2.
6. *Id.* at ¶ 19.
7. Société Générale also resolved an FCPA action on June 4. *See* United States Department of Justice, Press Release No. 18-722, "Société Générale S.A. Agrees to Pay $860 Million in Criminal Penalties for Bribing Gaddafi-Era Libyan Officials and Manipulating LIBOR Rate" (June 4, 2018), https://www.justice.gov/opa/pr/soci-t-g-n-rale-sa-agrees-pay-860-million-criminal-penalties-bribing-gaddafi-era-libyan.
8. Legg Mason NPA, Attachment A at ¶ 25.
9. *Id.*
10. *Id.* at ¶¶ 26, 41, 44.
11. Legg Mason NPA at 2.
12. Legg Mason NPA, Attachment A at ¶ 2.
13. *United States v. Bestfoods*, 524 U.S. 51, 61 (1998).

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Agency is an exception to the rule of corporate limited liability.[14] It takes two main forms: (1) as described in the Restatement of Agency, "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act;"[15] and (2) a situation in which "[d]omination [by a parent entity] may be so complete, influence so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary the agent."[16]

"The Legg Mason NPA also is noteworthy in that it assigns criminal liability to the corporate parent even though all of the wrongdoing allegedly took place at the level of a subsidiary."

Under the FCPA, any agent of a party subject to the anti-bribery provisions may itself be directly liable for a violation, allowing U.S. authorities to charge foreign individuals[17] and corporations[18] otherwise potentially beyond the reach of the anti-bribery provisions. The principal or parent also may be liable in one of two ways for the conduct of an agent or subsidiary: "First, a parent may have participated sufficiently in the activity to be directly liable for the conduct … Second, a parent may be liable for its subsidiary's conduct under traditional agency principles."[19] Direct liability can apply whenever the parent company is involved in, directs, or authorizes the underlying violation by its subsidiary. Given the breadth of direct liability for parents, principals, and agents, the need for the DOJ to resort to the

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14. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944).
15. *Restatement (Third) of Agency* § 1.01 (2006).
16. *Berkey v. Third Ave. Ry.*, 155 N.E. 58, 61 (N.Y. 1926).
17. *See, e.g., United States v. Jeffrey Tesler and Wojciech J. Chodan,* Indictment, Case No. Cr.- H-09-098 (S.D. Tex. Feb. 17, 2009); *United States v. Lawrence Hoskins and William Pomponi*, Second Superseding Indictment, Case No. 3:12-cr-00238 (D. Conn. July 30, 2013). While the conspiracy and aiding and abetting charges against Hoskins are currently before the Second Circuit, Judge Atherton refused to dismiss the direct FCPA charges on the grounds that agency was a matter for the jury to decide. *United States v. Hoskins*, 123 F.Supp.3d 316 (D. Conn. 2015).
18. *See United States v. Marubeni Corp.*, Doc. No. 1, Information at ¶ 13, Case 4:12-cr-00022 (S.D. Tex. Jan. 17, 2012). Although identified as an agent, Marubeni was charged with conspiracy and aiding and abetting rather than a direct violation.
19. U.S. Dep't of Justice & U.S. Sec. & Exch. Comm'n, *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, 27 (Nov. 12, 2012), available at https://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf.

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principle of agency arguably should be rare, especially given that any parent entity that is an issuer also may be directly civilly liable for books and records and internal control violations at its subsidiaries.

The DOJ's and the SEC's *Resource Guide to the U.S. Foreign Corrupt Practices Act* describes only one example of enforcement based on an agency relationship between a parent and its subsidiary: the SEC's cease-and-desist order against United Industrial Corporation ("UIC").[20] In that case, the SEC alleged that the president of the subsidiary (who was responsible for the improper payments) was an agent of the parent (in that he reported directly to the parent's CEO and was listed in the parent's filings as part of the parent's "senior management"). It also involved specific allegations of participation by employees of the parent, thereby providing for direct liability with respect to some of the transactions.[21] Similarly, the DOJ's declination with respect to CDM Smith, a parent corporation, concerned activities undertaken or authorized by senior management of CDM Smith's Indian subsidiary, all of whom "acted as employees and agents of CDM Smith and signed contracts on behalf of CDM Smith."[22]

The SEC also alleged anti-bribery liability based on corporate agency (rather than the agency of employees) in a 2012 settlement with Tyco International Ltd. ("Tyco"). Tyco was charged with violating the anti-bribery provisions of the FCPA through the actions of its U.S.-based subsidiary, TE M/A-COM, Inc. ("M/A-COM").[23] The SEC alleged that M/A-COM was an agent of Tyco for the purposes of the relevant corrupt transactions. Specifically, the complaint alleged that Tyco exerted control over the subsidiary by having officers serve in dual roles at both entities, such that four high-level Tyco officers were also officers of M/A-COM (including MA/COM's president). As such, even though there was "no indication that any of

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20. *In the Matter of United Industrial Corporation*, Corrected Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and Desist Order, Securities Exchange Act of 1934 Rel. No 60005, Accounting and Auditing Enforcement Rel. No. 2981, Admin. Proc. File No. 3-13495 (May 29, 2009) ("UIC Cease-and-Desist Order"). The *Resource Guide* also cites two cases in a footnote supporting the proposition that a subsidiary can be the agent of a parent. These cases, however, provide little guidance as to what the appropriate circumstances permitting such a finding would be. In *Pacific Can Co. v. Hewes*, 95 F.2d 42, 46 (9th Cir. 1938), the court noted that agency was a factual question, and permitted the case to go to the jury based on evidence that the parent exercised some control over the subsidiary, but did not itself determine whether those factors were sufficient to support finding an agency relationship. In *United States v. NYNEX Corp.*, 788 F. Supp. 16, 18 n.3 (D.D.C. 1992), the Court denied the parent corporation's motion to dismiss the indictment, merely noting that it was possible to hold a corporation liable for the acts of its subsidiaries.

21. UIC Cease-and-Desist Order at ¶ 27.

22. Letter from U.S. Department of Justice to Nathaniel B. Edmonds (June 21, 2017), https://www.justice.gov/criminal-fraud/pilot-program/declinations ("CDM Smith Declination). *Cf. Royal Industries Ltd. v. Kraft Foods, Inc.* 926 F. Supp. 407, 414 (S.D.N.Y. 1996) (subsidiary negotiating agreements to be performed by parent creates material issue of fact as to whether subsidiary is agent of parent); *Phoenix Canada Oil Co. Ltd. v. Texaco*, 842 F.2d 1466, 1478 (3d Cir. 1993) (noting negotiation of contract by parent to be carried out by subsidiary as one factor that could support a finding of agency with respect to that contract).

23. *SEC v. Tyco Int'l Ltd.*, 12-CV-1583 (D.D.C. Sept. 25, 2012), SEC Press Rel. No. 2012-196, SEC Charges Tyco for Illicit Payments to Foreign Officials (Sept. 24, 2012), http://www.sec.gov/news/press/2012/2012-196.htm.

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these individuals knew of the illegal conduct," the complaint held Tyco responsible as a principal. Notably, however, the SEC distinguished between this subsidiary and the other twelve named subsidiaries that were also alleged to have violated the FCPA. For the corrupt payments allegedly made by the twelve subsidiaries, Tyco was only charged with violating the FCPA's accounting provisions – for which parents in any event are virtually strictly liable.[24]

Agency Principles and the Legg Mason NPA

As in the Tyco matter, the Legg Mason NPA alleges that the subsidiary (Permal) acted as an agent of its parent (Legg Mason).[25] Unlike the Tyco complaint,[26] however, the Legg Mason NPA's assertion of agency rests on facts that appear to fall short of meeting the demanding standard required to overcome the presumption of corporate limited liability. The Legg Mason NPA categorizes Permal as Legg Mason's "agent"[27] based on the following factors:

(1) Permal was a majority-owned, and later wholly-owned and wholly-controlled, subsidiary of Legg Mason;

(2) Legg Mason conducted business through Permal, which acted for and on behalf of Legg Mason;

(3) Permal's financial statements were consolidated into Legg Mason's;

(4) The two entities participated in a net revenue sharing arrangement; and

(5) All of Permal's employees were subject to Legg Mason's Code of Conduct.

The Legg Mason NPA also states that the two Permal employees responsible for the conduct were "agents" of Legg Mason. Unlike in the UIC and CDM Smith matters, the Legg Mason NPA includes no allegations to support that assertion.[28]

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24. 15 U.S.C. § 78m(b)(2)(A); Paul R. Berger, Jonathan R. Tuttle, Bruce E. Yannett, Philip Rohlik, and Jil Simon, "Beyond 'Virtual Strict Liability': SEC Brings First FCPA Enforcement Action of 2018," FCPA Update, Vol. 9, No. 8 (Mar. 2018), https://www.debevoise.com/~/media/files/insights/publications/2018/03/fcpa_update_march_2018.pdf; Paul R. Berger, Andrew M. Levine, Bruce E. Yannett, and Philip Rohlik, "SEC Brings First FCPA Enforcement Actions of 2016," at 4, FCPA Update, Vol. 7, No. 7 (Feb. 2016), https://www.debevoise.com/~/media/files/insights/publications/2016/02/fcpa_update_february_2016.pdf.

25. Legg Mason NPA, Attachment A at ¶ 2-4.

26. It is debatable whether the allegations in Tyco were, in fact, sufficient to overcome the presumption of limited liability. *See Pacific Can Co.*, 95 F.2d at 46 ("It is held that proof of organization of one corporation by another, or ownership by one corporation of all the capital stock of another, or common officers and directors, is insufficient to show liability") (internal citation omitted). In any event, those allegations were more robust than the facts alleged in the Legg Mason NPA.

27. Permal is also a domestic concern within the meaning of 15 U.S.C. 78dd-2(h)(1). The employees were also categorized as employees of a domestic concern. Legg Mason NPA, Attachment A at ¶¶ 2.

28. *Id. at* ¶¶ 3-4. As employees of Permal, these two individuals theoretically would be sub-agents of Legg Mason, if it is accepted that Permal is an agent of Legg Mason.

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None of these assertions, alone or together, would seem sufficient to establish that Permal was Legg Mason's agent. Ownership is never sufficient to show agency.[29] Therefore, that Legg Mason owned Permal, without additional allegations, is insufficient to establish agency. By definition, a parent is often "involved" in the "macro-management of its subsidiaries," and it may do so "without exposing itself to a charge that each subsidiary is merely its alter ego."[30] In fact, "it is hornbook law that 'the exercise of the "control" which stock ownership gives to the stockholders . . . will not create liability beyond the assets of the subsidiary.'"[31]

Stating that Legg Mason conducted business through Permal and Permal "acted for and on behalf of Legg Mason" is similarly conclusory. Had the NPA included allegations that Permal acted on behalf of Legg Mason with respect to the Libyan transactions at issue, such a claim might meet the Restatement definition of agency (without the need to show domination). However, the NPA instead appears to be alleging merely that Permal performed services that were "important to the parent," which the U.S. Supreme Court recently held is insufficient, without more, to impute liability to the parent on an agency theory.[32]

Consolidation of financial statements is likely a relevant factor in an agency determination because it implies that the parent "controls" the consolidated entity, but it is not dispositive.[33] Furthermore, it is unclear how the fact that Legg Mason and Permal participated in a revenue-sharing relationship relates to establishing the control necessary to show agency. Revenue-sharing relationships are common both in the parent-subsidiary context and as between otherwise unrelated companies. While a revenue-sharing agreement (like any other agreement) could create agency by contract if both parties assent to the agent-principal fiduciary relationship,[34] one would expect the DOJ to have mentioned that fact in the NPA.

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29. *See Pacific Can Co. v. Hewes*, 95 F.2d 42, 46 (9th Cir. 1938) ("It is held that proof of organization of one corporation by another, or ownership by one corporation of all the capital stock of another, or common officers and directors, is insufficient to show liability") (internal citation omitted).

30. *Doe v. Unocal Corp.*, 248 F.3d 915, 927 (9th Cir. 2001).

31. *Bestfoods*, 524 U.S. at 62.

32. *See Daimler AG v. Bauman*, 571 U.S. 117, 134 (2014) (reversing the circuit court's holding that "[t]he agency test is satisfied by a showing that the subsidiary functions as the parent corporation's representative in that it performs services that are sufficiently important to the foreign corporation that if it did not have a representative to perform them, the corporation's own officials would undertake to perform substantially similar services").

33. *See United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 691–92 (5th Cir. 1985) ("In lieu of articulating a coherent doctrinal basis for the alter ego theory, we have instead developed a laundry list of factors to be used in determining whether a subsidiary is the alter ego of its parent. These include whether … (4) the parent and the subsidiary file consolidated financial statements and tax returns").

34. *Restatement (Third) of Agency* §§ 2.03, 3.03 (2006).

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The most puzzling allegation in the NPA with respect to agency is that "all employees of Permal were subject to Legg Mason's Code of Conduct." A parent may be liable, either directly under the FCPA or as a principal, when it directs the actions of its subsidiary's employees. However, expecting a subsidiary's employees to act in accordance with the parent's ethical standards would not seem to qualify – and courts have rejected attempts to impute agency based on codes of conduct and similar internal documents.[35] Moreover, the SEC and DOJ encourage companies to "promptly incorporate[] [an] acquired company [i.e., a new subsidiary] into all of its internal controls, including its compliance program."[36] It would seem odd for the DOJ to assert, as it appears to do in the Legg Mason NPA, that pushing down a compliance program will actually increase the likelihood of a parent company's liability on an agency theory.

Conclusion

Despite the DOJ's express recognition that Legg Mason and its employees were not involved in the wrongdoing, did not conspire to commit an offense, and did not aid and abet an offense, the DOJ opted for a criminal resolution with Legg Mason. In such circumstances, one might have expected that any action by the DOJ would have been brought against the subsidiary involved in the wrongdoing, while the parent, were it an issuer, would have been subject to SEC enforcement action.

Here, the entity involved in the wrongdoing, Permal, no longer exists. The DOJ therefore relied on a far-reaching theory of agency to impose liability on Permal's corporate parent. This does not appear to have been the DOJ's only option. Depending on the facts, the DOJ presumably could have pursued the entity into which Permal's asset management business was contributed under a successor liability theory, while leaving a resolution with Legg Mason (if any) to the SEC. Alternatively, the DOJ could have followed its stated policy of pursuing the two individuals responsible for the wrongdoing, while (again) leaving the parent to the SEC. Of course, the DOJ also could have declined to take any action, leaving the matter entirely to the SEC. Instead, the DOJ has expanded its reliance on an

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35. *See Joiner v. Ryder Sys. Inc.*, 966 F. Supp. 1478 (C.D. Ill. 1996) (holding that a parent company's implementation of safety policy, environmental policy, code of conduct, and code of ethics which each subsidiary was required to adhere to did not constitute improper control over subsidiaries, so as to support a finding that parent was alter ego of subsidiary that manufactured allegedly defective automobile transport trailer); *Fletcher v. Atex, Inc.*, 861 F.Supp. 242, 245 (S.D.N.Y.1994) ("[I]t is entirely appropriate for a parent corporation to approve major ... policies involving the subsidiary . . . ."), *aff'd*, 68 F.3d 1451 (2d Cir.1995).

36. *Resource Guide to the US Foreign Corrupt Practices Act, supra* n. 19 at 62.

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agency theory, doing so in a manner that potentially could set a precedent for similarly aggressive applications in future cases.

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