BERWIN LEIGHTON PAISNER'S CORPORATE CRIME AND INVESTIGATIONS COLUMN: JUNE 2015

Berwin Leighton Paisner LLP's Corporate Crime & Investigations team is led by partners *Aaron Stephens* and *Daren Allen*. The team regularly share their views on topical corporate crime and investigations issues with our subscribers.

In their column for June 2015, Aaron Stephens, Irene Cummins and Helen Armstrong consider:

- The implications of the FIFA corruption scandal in the UK.
- Developments in US insider trading enforcement actions.
- The recent High Court judgment in *Lord and others v Director of the SFO [2015] EWHC 865 (Admin)*, which highlights limitations on an individual's right to be accompanied by a solicitor at a witness interview with the Serious Fraud Office (SFO).

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THE FIFA CORRUPTION SCANDAL – A SPOTLIGHT ON ANTI-BRIBERY SYSTEMS AND CONTROLS

In our April 2015 *column*, we considered the FCA's business plan for 2015/16, noting that the regulator has identified as one of seven key risks and areas of focus for the year ahead the issue of firms having adequate systems and controls in place to prevent financial crime, including around bribery and corruption.

The emphasis on bribery in the business plan, released in March of this year, has proved to be quite prescient. The corruption allegations engulfing FIFA have led to criminal investigations in several countries, many of which were instigated in the wake of the US Department of Justice's (DoJ) indictment issued on 27 May, charging nine high-ranking FIFA officials with racketeering, wire fraud and money laundering conspiracies.

Here in the UK, the Serious Fraud Office (SFO) has indicated that it is actively assessing material relating to alleged corrupt payments to officials connected to FIFA. However, the SFO's remit is to consider investigating cases where, among other factors, the alleged offence(s) undermine confidence in the UK's commercial and financial institutions, and the City of London in particular, and where there is a significant public interest element. In the light of the apparent lack of a UK nexus in the DoJ's allegations against FIFA officials, it is not at all certain that the SFO will pursue a criminal investigation, at least based on the facts as currently reported.

What is perhaps more likely is the FCA asking questions of those banks that held accounts used to facilitate alleged illicit money transfers. Certain banks referred to in the indictment or in press coverage have indicated that they are conducting internal investigations into accounts that might be associated with FIFA officials. While there is no suggestion that any bank knowingly made or received corrupt payments or facilitated illicit money transfers, the FCA's regulatory powers may be invoked where it is found that firms have inadequate systems and controls to counter the risk of the bank being used to further financial crime, including bribery and corruption (see FCA Handbook, rule 6.1.1R in the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)). This means that the FCA can, in principle, levy a fine against a firm in circumstances where there is no evidence that the firm was aware that it had come into contact with illicit funds.

To the extent that investigations turn up any evidence that illicit funds passed through accounts because of insufficient controls, a firm would likely be required to disclose this to the FCA pursuant to Principle 11 of the FCA's Principles for Businesses (PRIN). Principle 11 requires regulated entities to disclose to the FCA anything which the regulator could reasonably expect to receive notice. Depending on the precise facts of a situation, this may well include serious failures in anti-bribery and corruption (ABC) systems and controls.

All banks should take note of the FIFA scandal, even if they are not caught up in it. The FCA does not have to wait for a bribe to be paid or for evidence of a bribe to take action – action can be taken against firms with deficient ABC systems and controls irrespective of whether actual bribery or corruption has taken place. In the past, the FCA has levied fines for breaches of Principle 3 (which states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems), in circumstances where there was no evidence or finding of any illicit payments being made (see the FCA final notices against *Aon Ltd*, *Willis Ltd*, *JLT Speciality Ltd* and *Besso Ltd*). Of course, any fines levied for failure to have in place adequate systems and controls are likely to be significantly higher if there is evidence that illicit transactions were allowed as a result of lax system and controls.

It is important to remember that the seven key risks identified in the FCA's business plan inform the allocation of resources across all regulatory activities at the FCA. The FCA has made it clear that, for the coming year, it will focus significant resources on examining systems and controls within the markets and firms that are most exposed to the risks of financial crime.

DEVELOPMENTS IN US INSIDER TRADING ENFORCEMENT ACTIONS

Recent cases in the US have highlighted the significant differences that exist between US and English law on the topic of insider trading/market abuse. One of the most interesting stems from the requirement (in US law) for the Securities and Exchange Commission (SEC)/DoJ to satisfy the "personal benefit" test to achieve convictions.

US insider trading law is derived from section 10b of the Securities Exchange Act 1934 and Rule 10b-5 promulgated thereunder. However, the real substance of the law has been developed over many years by the courts. During this time, two separate theories of insider trading have evolved: the "classical" theory and the "misappropriation" theory.

CLASSICAL THEORY

The classical theory applies to corporate "insiders" (for example, officers or directors of the issuer whose stock is the subject of trading activity, but also any external advisers, such as lawyers, who owe duties to the company or its shareholders). The elements of liability can be summarised as follows:

- an insider;
- who, in breach of his fiduciary duty to the company or its shareholders;
- either:
  - trades for himself on the basis of the company's material non-public information; or
  - provides the information to an outsider (a "tippee") in return for some personal benefit;
- thereby defrauds his company and its shareholders (as does any co-schemer like the tippee).

MISAPPROPRIATION THEORY

The misappropriation theory applies to "outsiders" (that is, individuals who are not insiders and do not owe any duties to the company or shareholders). The elements of liability can be summarised as follows:

- an outsider;
- who, in effect, "embezzles" material non-public information from a company or other source;
- in breach of a duty owed to the source of the information;
- either:
  - trades on it; or
  - in return for a personal benefit, provides it for trading purposes to a tippee;
- thereby defrauds the source of the information (as does any co-schemer like the tippee).

RECENT DEVELOPMENTS

According to recent authority from the 2nd Circuit Court of Appeals (United States v Newman), to prosecute a tippee (including any secondary or even more "remote" tippee) in a "classical" case, all of the following elements must be proved:

- the insider was entrusted with a fiduciary duty;
- the insider breached his duty by (a) disclosing confidential information to the tippee; (b) in exchange for a **personal benefit**;
- the tippee knew of the insider's breach (that is, he **knew** the information was confidential **and** that it was divulged for a personal benefit); and
- despite this knowledge, the tippee still used the information to trade in a security or to tip another individual for personal benefit.

It was also confirmed by the court that the elements of tipping liability are the same where the tipper's duty arises under the "misappropriation" theory.

Prior to Newman, the US government's position was that where an insider tipped information to a friend or personal acquaintance, the "personal benefit" test was automatically satisfied because it was to be inferred that the tipper received a personal benefit in exchange for the tip. In addition, the government's view was that for liability to arise, it did not need to prove that a remote tippee knew that the tipper had provided the tip for a personal benefit.

However, Newman has raised the bar considerably by providing further detail on when such an inference can (and cannot) be drawn on the basis of a friendship or personal relationship. Specifically, the Court of Appeals stated that to infer a benefit from a personal relationship, there must be proof of:

- "a **meaningfully close personal relationship** that generates an exchange that is **objective, consequential** and represents **at least a potential gain** of a pecuniary or similarly valuable nature."

On the facts of Newman (in which the defendants had been convicted at first instance), the Court of Appeals decided that:

- There was insufficient evidence to prove that the corporate insiders in question received a "personal benefit" in exchange for their tips.

- Jury instructions erroneously permitted conviction without any proof that the defendants knew the tips were provided by the insiders in exchange for a personal benefit.

The upshot of the case is that, going forward, the SEC and DoJ will have a heavier evidential burden than in the past and will need to prove both (a) the existence of a substantial quid pro quo between the original tipper and tippee; and (b) the defendant's knowledge of that quid pro quo. This will be particularly difficult to do, especially in cases where the defendant received the inside information via several intermediate sources.

US law on this topic is significantly different to English law, which does not require any proof of a "personal benefit" to a tipper, or proof that a tippee was aware of the personal benefit. Indeed, the English civil and criminal regimes create explicit offences where a person merely encourages another to deal in price-affected securities when in possession of inside information, or discloses inside information other than in the proper performance of his employment, office or profession.

SFO TIGHTENS CONTROL OVER WITNESS INTERVIEWS – OR DOES IT?

The recent High Court judgment in *Lord and others v Director of the SFO [2015] EWHC 865 (Admin)* has highlighted the limitations on an individual's right to be accompanied by a solicitor at a witness interview with the SFO.

Section 2 of the Criminal Justice Act 1987 (CJA) gives the SFO the power to summons a witness to an interview where they can be required to answer any questions put to them (although notably this compulsion does not extend to information covered by legal professional privilege). You might assume that in such circumstances the witness would be entitled to be accompanied by a lawyer as of right. However, in this case the High Court confirmed that there is no common law or statutory right to be accompanied by a solicitor at an interview conducted under section 2 of the CJA. Any ability to be accompanied by a lawyer is a matter of policy for the SFO (and traditionally the SFO has as a matter of policy permitted witnesses to be accompanied by a lawyer). Moreover, the SFO can restrict a witness' ability to be accompanied by a particular lawyer where there is good reason to do so.

The case concerned three employees of GlaxoSmithKline (GSK) who were summoned to attend section 2 interviews in connection with the SFO's investigation into allegations of bribery and corruption at GSK. The employees requested that a representative from GSK's external counsel (Arnold & Porter) attend the interviews to provide legal advice and assistance to them. The SFO initially refused the request outright. Although it eventually permitted a lawyer to attend, it continued to object to the presence of an Arnold & Porter lawyer on the basis that this might prejudice the investigation.

The employees challenged this decision by way of judicial review, arguing that they were entitled to have a solicitor of their own choice present at the interview (including the company's own external counsel). In summary, the main grounds of challenge were::

- Illegality – a witness attending a compelled SFO interview is entitled to have a lawyer of their choice present.
- Wednesday) unreasonableness – it was irrational not to allow a witness their lawyer of choice at the interview.
- Procedural impropriety – the refusal contradicted (or applied in a blanket fashion) the SFO's policy set out in the SFO handbook.

The Court of Appeal upheld the first instance judgment, finding that the SFO had acted in accordance with its policy, which was a lawful policy and that the reasons given for applying the policy as it had were reasonable and properly open to it. In particular, the court held in relation to the above grounds of challenge:

- As there was no common law right to have a solicitor present throughout a police interview (see *Crown v Chief Constable of the Royal Ulster Constabulary (ex parte Begley & McWilliams) [1971] 1 WLR 1475*), and as no express or implied statutory entitlement could be found in the CJA, the SFO was not legally required to permit a lawyer to accompany a witness in a section 2 interview.
- The decision was not irrational or perverse – reasonable justification had been provided for why attendance by GSK's lawyer may prejudice the investigation (including, for example, the lawyer's obligation to inform GSK of certain information or the employees speaking with less candour given their presence, or both).
- The SFO's policy as set out in its handbook was to permit defence legal advisers to attend section 2 interviews unless their attendance in any way prejudiced the investigation – the SFO had acted in accordance with that policy and applied it to the particular circumstances at hand.

One issue raised by the applicants was that a company under investigation is effectively reliant on the employee and their independent solicitor (who may have much less knowledge of the company or investigation, or both) to assert the company's privilege over information. That said, the court did acknowledge there was no bar on the employees (or their independent solicitor) speaking to Arnold & Porter before the interview to seek their advice and guidance in this regard. Nor was there a bar on the independent lawyer communicating with GSK or Arnold & Porter about the content of the interviews after they had taken place.

However, this then begs the question: how useful is the SFO's refusal to allow corporate counsel to attend an employee's section 2 interview in practice? Arguably, the only thing it causes is an increase in the fees paid by the company in briefing a new solicitor at short notice.

Whether any prejudice would in fact be caused by allowing corporate counsel to attend in circumstances where an employee genuinely wishes them to do so remains to be seen. The FCA is certainly more willing for corporate counsel to attend an interview (often alongside independent counsel) if the witness believes it would be helpful. Hopefully the SFO will consider each situation on its specific facts, but it will undoubtedly be tempted to simply raise the same points of potential prejudice in relation to any and all requests for corporate counsel to attend a section 2 interview.