BLP Corporate Crime & Investigations column: November 2015

- **Resource type: Article**
- **Status: Published on 27-Nov-2015**
- **Jurisdictions: USA, United Kingdom**

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 November Aaron Stephens, Joanna Harris and Georgia Henderson-Cleland consider:

- The US Department of Justice hires a compliance expert: bright idea or a step in the wrong direction?
- Jamie Symington's speech internal investigations: laying some ground rules for regulated firms.
- OFSI: a "UK OFAC"?
- Hitachi gets hit with FCPA charges.

Aaron Stephens, Joanna Harris and Georgia Henderson-Cleland of Berwin Leighton Paisner

---

The US Department of Justice hires a compliance expert: bright idea or a step in the wrong direction?

On 3 November 2015, the Fraud Section of the US Department of Justice (DOJ) hired Hui Chen as its first full-time compliance expert. Ms Chen held previous senior compliance roles at Pfizer, Microsoft and Standard Chartered Bank and has relevant US, UK and Chinese experience.

The news has been met by mixed responses. Some see it as a strong and positive message that the DOJ is serious about assessing compliance regimes and factoring into its charging decisions whether or not the regime "cuts the mustard". Indeed, when the news first came out this summer that the DOJ was looking to hire a compliance professional, Andrew Weissman, head of the Fraud Section, told *The Wall Street Journal* that the idea was to hire a professional who would "*differentiate the companies that get it and are trying to implement a good compliance program from the people who have a near-paper program*."

However, some have seen Hui Chen's appointment as a calculated attempt to appease those who have called for a compliance-based defence – such as the "adequate procedures" defence in section 7 of the Bribery Act 2010 – enshrined in US law. Critics of the current position, whereby a corporate compliance program is just one of many factors that the DOJ may take into account when deciding whether to open an investigation or charge, see such a defence as necessary in order to provide a consistent and transparent approach that would further incentivise companies to develop good compliance programs.

At the American Bar Association's *Global White Collar Crime Institute* in Shanghai on 19 November 2015, the Deputy Assistant Attorney General of the DOJ's Criminal Division (Sung-Hee Suh) noted that Ms Chen's job would be to assist prosecutors in assessing corporate compliance programs to determine whether they: (i) are well designed; (ii) are applied earnestly and in good faith; and (iii) work in practice. In her remarks, Ms Suh drew out the issue of the resourcing of compliance, and it was made clear that one area that Ms Chen will focus on is whether a company's compliance function has adequate funding and stature in the organisation.

Real world efficacy in compliance requires the full engagement of senior management. It needs to be clear that they truly "buy in" to the need to implement an effective compliance program. There is no question that one of the most positive effects of the section 7 defence has been to help focus minds in this way. Whilst a statutory defence in the FCPA would arguably give more certainty to companies, Ms Chen's appointment may also go some way towards helping compliance professionals focus the minds of the people around them on the need for establishing and maintaining a serious, adequately resourced compliance regime.

Jamie Symington's speech internal investigations – laying some ground rules for regulated firms

Jamie Symington, Director in Enforcement (Wholesale, Unauthorised Business and Intelligence), delivered a speech on Internal Investigations by firms on 5 November 2015.

The speech discussed some of the important factors that are balanced by the FCA when weighing up the extent to which they can rely on a firm's internal investigations, and Mr Symington identified several core principles including early engagement with the FCA, risk management and transparency. He also set out a specific list of "ground rules" that the FCA would seek to establish with a firm which is conducting an internal investigation. You can read these in full *here (www.practicallaw.com/5-620-0378)* .

In particular, Mr Symington highlighted two areas which will be familiar hot spots for those conducting internal investigations:

Involving the FCA in scoping an investigation

Firms and their lawyers are already expected to involve the regulator in scoping any investigations. In his speech, Mr Symington reiterated the importance of this.

Whilst acknowledging that firms may "balk" at involving the FCA as a "one-way benefit", he explained that, down the line, it may save time in trying to convince the FCA that the scope chosen and the methods employed hold up to scrutiny. Where the FCA is not involved in the initial scoping discussions, it may conclude that it cannot rely on the report and will therefore need to redo the investigation.

Privilege

Many practitioners will look apprehensively at Mr Symington's comments on privilege. Whilst he said that he understood the need to claim and protect privilege where "appropriate", he delivered an unambiguous message, coupled with another gentle warning that the FCA is losing its patience:

"Let me be clear: where firms propose to carry out or commission an internal investigation themselves – the starting point is that we expect them to share the core product of their investigation – i.e. the evidence – with us.

If firms wish to get the benefits of carrying out their own investigation, they need to accept that as a regulator we will not accept terms where we will not get access to the product in a sensible and practicable manner."

In particular, Mr Symington lambasted two specific behaviours:

1. investigations only producing lawyers' notes of interviews of employees – no recordings or notes by others, including the interviewee – and then arguing that the notes of the interview are privileged; and
2. firms asking to read aloud the output from investigations in a meeting, rather than to commit material into documentary form.

Mr Symington said that the first of these behaviours was seen by the FCA as "*gaming*" to shroud the output of an investigation in privilege. Mr Symington said that the second "*just doesn't pass the smell test*", and that the general public would find the concept "*absolutely extraordinary*". There could be no clearer message as to the negative impact on how the FCA views an investigation that adopts these practices, notwithstanding how commonplace they may be. (For further information on Privilege in Internal investigations see *Legal update, FCA speech on internal investigations by firms (www.practicallaw.com/5-620-0383)* .)

The "smell test" is also a good example of how Mr Symington framed his speech around the importance of the public perception; from the start, he focused on the potential risk to the regulator if it is perceived as being taken for a ride. He said: *"For example, I noticed media commentary on one of our recent cases where the practice* [of internal investigations] *was characterised as firms being allowed to 'mark their own homework*". He went on to say that "*if internal investigations are to play a useful role, clearly the regulator cannot –* ***and cannot be seen*** *– naively to accept firms' reports and conclusions. Let me be clear: that is not how we work*" [emphasis added].

Mr Symington's comments fall right at the heart of the conflict often felt between lawyers conducting internal investigations and the regulator, and can be read as a gentle warning: don't make a fool out of us, and we won't make a fool out of you.

OFSI: a "UK OFAC"?

2015 has been a significant year in the world of financial sanctions. From highly complex, swiftly imposed, multilateral international sanctions imposed against Russia, to a slow lifting of US financial sanctions against Cuba, to the countdown to "Implementation Day" and the waiving of certain sanctions against Iran, financial sanctions legislation and enforcement have been of growing interest and concern to all types of businesses.

In this context the following statement, buried the Budget 2015, takes on a certain significance: "*The government will review the structures within HM Treasury for the implementation of financial sanctions and its work with the law enforcement community to ensure these sanctions are fully enforced, with significant penalties for those who circumvent them. This review will take into account lessons from structures in other countries, including the US Treasury Office of Foreign Assets Control (OFAC)*." It is clear from this that HM Treasury considers OFAC, with its application of broad sanctions and wide enforcement powers, to be an aspirational model for UK sanctions policy.

As noted briefly in our *September article (www.practicallaw.com/8-618-6917)* , this was expanded in the Summer Budget 2015, in which it was announced that the UK Government would establish a new Office of Financial Sanctions Implementation (OFSI) within HM Treasury by April 2016. It was stated that the purpose of OFSI would be to "*provide a high quality service to the private sector*", as well as "*working closely with law enforcement to help ensure that financial sanctions are properly understood, implemented and enforced*". This clear message in relation to increased and "proper" enforcement has caused commentators to highlight the potential for OFSI to mimic the aggressive enforcement approach taken by OFAC.

So what are the implications of a "UK OFAC"? Under current UK legislation (putting FCA and PRA regulatory enforcement to one side), sanctions violations can only be addressed by criminal prosecution, with a maximum of 2 years' imprisonment, or an unlimited fine for those found to be in breach. Under US legislation, OFAC can impose civil penalties, and can also negotiate out of court settlements in relation to sanctions violations. Indeed, the $9 billion fine imposed on BNP Paribas for sanctions violations, the largest ever sanctions-related fine, was agreed as part of a "deal" between BNP Paribas and OFAC. If OFSI were to enjoy the broader investigatory and enforcement powers of OFAC, UK businesses may face more rigorous scrutiny, more aggressive investigations, and higher financial penalties.

How should UK businesses deal with this? There is significant potential that the prospect of large fines may be another reason that businesses and financial institutions take steps to "de-risk" - that is, cease carrying out business in what are perceived to be higher-risk sectors or markets. A wide approach to de-risking may leave some businesses and organisations unable to access finance in jurisdictions affected by sanctions. It has been emphasised by various regulators that wholesale de-risking is not indicative of a healthy compliance program, and that effective policies and procedures, exercised with judgement and common sense, should constitute an effective risk-based approach.

The nature of OFSI, its budget, staff and powers, will be dependent upon the legislation establishing it, which is yet to be published.

Hitachi gets hit with FCPA charges

In late September 2015 it was announced that the SEC had charged Hitachi Ltd with violating the accounting provisions of the Foreign Corrupt Practices Act 1977 (FCPA) (see press release *here*). Without admitting or denying the SEC's allegations, Hitachi agreed to pay $19 million to settle the charges.

Hitachi is headquartered in Japan and the alleged violations related to power projects in South Africa, so there was no obvious US jurisdictional nexus. However, at the time of the alleged violations Hitachi had American Depositary Shares (ADSs) registered with the SEC and traded on the New York Stock Exchange (Hitachi delisted these shares in 2012). The ADSs made Hitachi an "issuer" at the relevant time and thus subject to the accounting provisions of the FCPA. This is a timely reminder of the extra-territorial effect of the FCPA and the consequence of having a US listing, including by way of an ADS or American Depositary Receipt (ADR) program.

The SEC alleged that Hitachi's German subsidiary,Hitachi Power Europe GmbH (HPE), worked with a South African consultant in connection with its efforts to enter the South African power market from 2005 onwards. The consultant was also engaged by a South African subsidiary called Hitachi Power Africa (Pty) Ltd (HPA) which had been incorporated specifically for the purpose of creating a local presence for pursuing contracts with public and private entities in South Africa, including the government-owned power utility Eskom Holdings SOC Ltd (Eskom). It was noted that from 2006 to at least 2008, Eskom's chairman also served as a member of the National Executive Committee of the African National Congress (ANC), South Africa's ruling political party.

Pursuant to the requirements of the Black Economic Empowerment Act of 2003 (BEE), HPA needed to partner with a South African entity that was at least 25% owned by black South Africans or black-owned South African entities. By complying with BEE, HPA would benefit from preferential status in the context of any tenders for government procurement projects.

HPA's alleged mistake was that in identifying this local partner, it prioritised the partner's ability to exert political influence in South Africa over any engineering or operational capabilities. The local partner that it chose was Chancellor House Holdings (Pty) Ltd (Chancellor), which was a company established by the ANC as a funding vehicle. The partnership with Chancellor included HPE and Chancellor entering into a shareholders agreement via which HPE sold Chancellor 25% of HPA for "only" $190,819.

In addition, HPA entered into a separate and "secret" success fee arrangement with Chancellor, which resulted in Chancellor being paid over $1.1 million in success fees upon HPA being awarded contracts by Eskom. This was in addition to any dividends that Chancellor would receive from its shareholding in HPA.

Assisted by some rather unhelpful (from Hitachi's point of view) email evidence, the SEC's complaint sought to demonstrate that the engagement of Chancellor was a deliberate scheme to curry favour with key individuals associated with Eskom in order to win contract tenders. Hitachi was awarded two contracts, one for $2.91 billion and one for $2.71 billion, to build boiler works for power stations.

In accounting for the success fees and dividends paid to Chancellor (amounting to over $10 million – thus a 5,000% return on Chancellor's investment in HPA), HPA made a further mistake. The payments were recorded as "consulting fees" and dividends rather than,on the SEC's case, reflecting the true nature of the payments by describing them as payments made to a foreign political party for its assistance in securing contracts. The HPA financial statements were consolidated into Hitachi's financial statements as filed with the SEC. These inaccurate entries along with accompanying failures in HPA's internal accounting controls is what resulted in the SEC's enforcement action.

A further point of interest is that in the SEC's press release regarding this settlement, it noted the assistance of various different agencies and third parties, including the African Development Bank. The press release states: *"We particularly appreciate the assistance we received from the African Development Bank's Integrity and Anti-Corruption Department and hope this is the first in a series of*

collaborations." This is a timely reminder that development finance institutions not only carry out their own investigations into alleged corruption (resulting in debarment decisions where appropriate), but are also ready and willing to share the work product of their investigations with civil and criminal authorities around the world.

Resource information

Resource ID: 4-620-4386

Published: 27-Nov-2015

Products: Business Crime & Investigations, PLC UK Commercial, PLC UK Financial Services

Related content

Topics

Financial Crime (http://uk.practicallaw.com/topic7-103-1182)

Financial Services Offences (http://uk.practicallaw.com/topic4-607-9655)

©2015 Thomson Reuters. All rights reserved. Privacy Policy and Cookies(http://www.practicallaw.com/3-386-5597).Legal Information(http://www.practicallaw.com/8-531-0965). Subscription enquiries +44 (0)20 7202 1220 or email subscriptions@practicallaw.com. The reference after links to resources on our site (e.g. 2-123-4567) is to the PLC Reference ID. This will include any PDF or Word versions of articles.