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KING & SPALDING: TRANSATLANTIC BUSINESS CRIME AND INVESTIGATIONS MAY COLUMN

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King & Spalding's Special Matters and Government Investigations team shares its views on developments in transatlantic business crime and investigations.

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KING & SPALDING'S SPECIAL MATTERS AND GOVERNMENT INVESTIGATIONS TEAM SHARES ITS VIEWS ON DEVELOPMENTS IN TRANSATLANTIC BUSINESS CRIME AND INVESTIGATIONS

Judge chastises Department of Justice for outsourcing investigation to outside Corporate counsel, but US independent investigations continue with focus on cooperation

Introduction and overview

Earlier this month a US federal judge from the Southern District of New York, Judge McMahon, ruled that a criminal defendant was unconstitutionally compelled to give testimony during a government-directed internal investigation carried out by the defendant's employer (a global investment bank). In so ruling, the judge was scathing in her criticism of the US government for effectively "outsourcing" its investigation to the bank and its outside counsel. Some commentators have forecasted a sea change in how US internal investigations will operate going forward. The UK's Serious Fraud Office (SFO) wrestled with similar issues some years ago during the *Dahdaleh* trial, which led to the defendant's court-ordered acquittal. Some have credited the SFO's struggles in *Dahdaleh* with an unofficial SFO policy prohibiting over-reliance on corporate internal investigations. For more information see *Article, Berwin Leighton Paisner's corporate crime and investigations column: January 2014*. Ultimately, the stern tone of Judge McMahon's decision may be attributable to other factors. Going forward, it is likely to have more impact on what government attorneys say, but less impact on what attorneys overseeing internal investigations do in practice.

US government outsources Libor investigation

The Fifth Amendment of the US Constitution protects criminal defendants from being compelled to testify against themselves. Generally, this issue comes up during law enforcement interviews, grand jury testimony and criminal trials. But it can also come up during internal investigations by private companies if either an employee is compelled to submit to an interview by their employer's counsel under threat of termination or if the interview can be specifically attributed to the government. Most major corporations have policies that allow for termination if an employee refuses to co-operate with an internal investigation, so the key issue is really government attribution.

In *U.S. v. Connolly et. al*, Judge McMahon found that a global investment bank's interviews of an employee regarding Libor submissions were both compelled and fairly attributable to the Commodity Futures Trading Commission and the Department of Justice (DOJ). McMahon concluded that the bank's counsel interviewed Black at the government's direction. In fact, the court found that the government selected all of the employees to be interviewed during the first portion of the internal investigation. Further, according to the court, government prosecutors gave specific instructions to the attorneys running the internal investigation regarding an interview of another employee: "[A]pproach [the] interview…as if [you] were a prosecutor." Judge McMahon concluded that the bank's counsel had done everything that the government would have done if it were pursuing its own investigation, and that there was scant evidence of any parallel government investigation. Accordingly, it was determined that the government had violated the defendant's 5th Amendment right against self-incrimination (as articulated in *Garrity v. New Jersey, 385 U.S. 493 (1967)*). However, since the government prosecutors had not used the compelled statements in any meaningful way at the individual's trial, his motion for relief under *United States v. Kastigar, 406 U.S. 441 (1972)* was denied.

Dahdaleh and SFO independence

The SFO has traditionally taken a different approach to the US when it comes to relying on the product and conclusions of a company's internal investigation. Generally speaking, the SFO will carry out its own independent investigation. However, in 2013 the SFO's bribery case against Victor Dahdaleh fell apart and the judge ordered an acquittal, in part because the SFO was found to have relied on an internal investigation run by the law firm Akin Gump. Attorneys for Akin Gump were meant to appear at trial and give testimony but refused to appear at the last minute. It is believed that the breakdown of this case is one reason why the SFO has sought to adopt a stricter approach on this issue in subsequent years, in some cases actively seeking to restrict a company's outside counsel from carrying out too much investigative work. However, with an American, Lisa Osofsky, now in charge of the SFO, it is possible that the SFO's posture toward outside counsel investigations could change.

Dramatic changes in US internal investigations unlikely

Despite Judge McMahon's notable decision, including strong language placing 5th Amendment protections above the DOJ's policies to encourage cooperation, dramatic changes in US internal investigations are unlikely. First, the strength of Judge McMahon's warnings was likely due in part to the government's refusal to provide additional evidence about its communications with counsel for the bank and its own independent investigative steps. Frustration with the incomplete record is evident in the decision, but it may make this opinion something of an outlier. Second, government prosecutors can avoid future violations by declining to give specific instructions to counsel running investigations, but the same incentives will still exist for companies to co-operate as much as possible. While prosecutors may change what they say, counsel running internal investigations may continue counselling cooperation without significant changes.

DOJ issues updated guidance on corporate compliance programs

On 30 April 2019, the US DOJ unveiled updated guidance on its *evaluation of corporate compliance programs*, expanding on previous guidance on this topic issued in February 2017. The new guidance explains how federal prosecutors will examine the effectiveness of a company's compliance program at the time of an offence and at the time of a charging decision or resolution.

The updated guidance articulates three fundamental questions that prosecutors are expected to ask:

- Is the corporation's program well designed?
- Is the program being applied earnestly and in good faith? In other words, is the program being implemented effectively?
- Does the corporation's compliance program work in practice?

In explaining the factors that prosecutors will examine to answer these questions, the guidance offers helpful insight for companies to also assess their own compliance programs and detect and address any shortcomings.

Is the corporation's compliance program well designed?

According to the DOJ *evaluation of corporate compliance programs*, the starting point for prosecutors' evaluation of a well-designed compliance program is risk assessment. Companies need to engage in ongoing assessment of risks presented by various factors, including "the location of its operations, the industry sector, the competitiveness of the market, the regulatory landscape, potential clients and business partners, transactions with foreign governments, payments to foreign officials, use of third parties, gifts, travel, and entertainment expenses, and charitable and political donations."

Proper resource allocation is key. The updated guidance emphasizes that companies should allocate compliance resources to high-risk areas. Scarce resources should focus on high-risk transactions (such as "a large dollar contract with a government agency in a high-risk country") rather than on "more modest and routine hospitality and entertainment." Risk assessments should also be periodically updated over time as the company grows and as new risks are discovered through instances of misconduct.

Two risk areas specifically emphasized are management of third-party relationships and proper due diligence of acquisition targets. Companies must do a deep dive into their third-party relationships and consider whether contract terms with third parties "specifically describe the services to be performed, that the third party is actually performing the work, and that its compensation is commensurate with the work being provided in that industry and geographical region." With respect to acquisition targets, the guidance stresses pre-acquisition due diligence to identify and cure any exposure posed by the acquired company.

The updated guidance also stresses that a well-designed compliance program has robust policies and procedures, as well as training for its employees. Policies and procedures must deal with the range of different risks that the company faces and must be accessible by foreign employees.

Training should likewise be provided based on risk and should include "all directors, officers, relevant employees, and, where appropriate, agents and business partners." The training should be delivered "in a manner tailored to the audience's size, sophistication, or subject matter expertise, and it should "give practical advice or case studies to address real-life scenarios, and/or guidance on how to obtain ethics advice on a case-by-case basis as needs arise."

The DOJ also emphasized that employees should have clear and accessible ways to report misconduct. Confidential reporting mechanisms are essential, and companies must "rout[e] complaints to proper personnel," timely investigate such complaints and engage in "appropriate follow-up and discipline." Finally, it is important to "periodically analyse the reports or investigation findings for patterns of misconduct or other red flags for compliance weaknesses."

Is the program being applied earnestly and in good faith? In other words, is the program being implemented effectively?

In addition to building a robust compliance program, as detailed in the *evaluation of corporate compliance programs* the DOJ will look to how the program is implemented to examine whether it is a "paper program" or one "implemented, reviewed, and revised, as appropriate, in an effective manner."

Part of this analysis is an examination of the company's "tone at the top" – whether the company's leadership has expressed a high commitment to a culture of compliance. The focus will not just be on whether management has issued communications and slogans touting compliance, but will also be on how management has led by example. "Have managers tolerated greater compliance risks in pursuit of new business or greater revenues? Have managers encouraged employees to act unethically to achieve a business objective, or impeded compliance personnel from effectively implementing their duties?"

Autonomy and resource allocation are important. Companies should evaluate whether those responsible for compliance have: "(1) sufficient seniority within the organization; (2) sufficient resources, namely, staff to effectively undertake the requisite auditing, documentation, and analysis; and (3) sufficient autonomy from management, such as direct access to the board of directors or the board's audit committee." The guidance acknowledges, however, that these factors will also depend on the size, structure, and risk profile of the particular company.

Does the corporation's compliance program work in practice?

Companies' compliance programs must work effectively to identify and remediate misconduct. Prosecutors will examine "whether and how the misconduct was detected, what investigation resources were in place to investigate suspected misconduct, and the nature and thoroughness of the company's remedial efforts." The guidance notes that the mere existence of misconduct will not be taken as a sign that a program was ineffective.

For companies doing business in the UK, the SFO has indicated that it will release new guidance that speaks to self-reporting as a means of misconduct remediation. The guidance will clarify what companies should expect when reporting fraud and corruption to the SFO, including an increased likelihood of striking a deferred prosecution agreement (DPA), under which the company avoids being prosecuted in return for a fine and cooperation with the agency. This guidance will, in some respects, supplement the existing Ministry of Justice guidance on adequate procedures under the *Bribery Act 2010*, but despite various calls for better guidance from the SFO on what it looks for when evaluating a company's compliance systems and controls, the SFO has not indicated that it will publish guidance similar to the DOJ's updated guidance.

Finally, the DOJ's new guidance encourages companies not to rest on their laurels, because "one hallmark of an effective compliance program is its capacity to improve and evolve." Continuing analysis of the compliance program, including periodic deep dives into potentially risky or problematic areas, will help inform prosecutors when they "consider whether the company has engaged in meaningful efforts to review its compliance program and ensure that it is not stale."

New developments in spoofing

In an interesting twist on spoofing prosecutions, in April 2019, US prosecutors dropped charges against software developer Jitesh Thakkar after his trial ended in a hung jury. Thakkar, the founder and president of Edge Financial Technologies, was the first non-trader to be charged as a spoofing co-conspirator. Thakkar was accused of aiding and abetting British "flash crash" trader Navinder Singh Sarao, who pleaded guilty to wire fraud and spoofing and testified against Thakkar as part of his plea deal.

Sarao, who traded tens of thousands of E-mini futures contracts in calculated, short term intervals to take advantage of the price movements, admitted that he made more than $12 million as a result of his trades. The government alleged this scheme would not have been possible without Thakkar's technology. Prosecutors alleged that evidence of e-mails between the two showed Thakkar's awareness of Sarao's scheme — specifically, as spoofing is accomplished by placing bids or offers while having the contemporaneous intent to cancel the orders before they are filled, e-mails included discussion of certain features in the technology designed to lessen the likelihood that a desired spoofing order would be inadvertently executed.

Despite Sarao's testimony, mid-trial, the judge dismissed the charge of conspiracy, as Sarao refused to acknowledge the existence of an agreement with Thakkar. After the mistrial, prosecutors dropped the remaining charges without public comment, but Thakkar's attorney slammed the government's "substantial lack of judgment" in bringing the case. See *Flash Crash trader fails to help feds bring conviction in spoofing case - Chicago Sun-Times.*

If the prosecutors had succeeded in convicting Thakkar, it may have opened the door to future prosecutions against programmers, and specific targeting of the use of "smart contracts" that are written directly into software code utilized by traders. The decision to drop the charges, however, raises questions as to whether individuals a step removed from trading could or will be pursued again in the future, either in the US or UK.

Practical Law will shortly be publishing a new practice note, written by King & Spalding, that summarises and compares US and UK law and enforcement on the topic of spoofing. Specifically, the note considers how each jurisdiction's enforcement bodies prosecute spoofing under applicable law and provides examples of the types of trading practices that may constitute spoofing.