Debevoise & Plimpton

FCPA Update
December 2016
Volume 8
Number 5

FCPA Update

A Global Anti-Corruption Newsletter

Also in this issue:

7 UK Proposes New Legislation Targeting Proceeds of Crime

Click here for an index of all *FCPA Update* articles

If there are additional individuals within your organization who would like to receive *FCPA Update*, please email prohlik@debevoise.com, eogrosz@debevoise.com, or pferenz@debevoise.com

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

In a novel application of the books and records and internal controls provisions of the Securities Exchange Act of 1934, on December 2, 2016, the U.S. Securities and Exchange Commission ("SEC") issued a Cease and Desist Order against United Continental as a result of the approval of a new flight route by the then-CEO outside the company's normal internal processes and policies.[1] Given the historic lack of clarity surrounding these accounting provisions added by the Foreign Corrupt Practices Act ("FCPA"), the SEC's settlement with United suggests the SEC may seek to expand the use of these provisions in circumstances in which it believes there has been improper corporate behavior but does not have another clear statutory violation.

Continued on page 2

1. *See In the Matter of United Cont'l Holdings, Inc.*, Exchange Act Release No. 79454, 2016 WL 7032725 (Dec. 2, 2016) (the "Order").

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

Continued from page 1

Relevant Conduct of United

The Order asserts that, although Continental Airlines terminated a direct flight route from Newark, New Jersey, to Columbia, South Carolina, prior to its merger with United due to its unprofitability, the former CEO of United, Jeff Smisek, approved the reinitiation of this route under pressure from David Samson, then Chairman of the Board of Commissions of the Port Authority of New York and New Jersey, outside of normal internal processes and policies. Samson had lobbied for a more direct flight from Newark to his home in the South Carolina city since early 2011, after he was appointed Chairman of the Port Authority. According to the Order, despite a preliminary financial analysis predicting losses from the Newark-Columbia route and a managing director's advice against it, United's CEO authorized the route after the Port Authority removed voting on leasing three acres of Newark Liberty International Airport land to United from the Port Authority's November 2011 board meeting agenda and appeared prepared to remove it again from the December 2011 agenda. Securing this three-acre plot lease was crucial for United, which stood to gain an estimated $47.5 million per year in value from the hangar it planned to construct on the land. The lease for the hangar was approved by the Port Authority the same day United's CEO approved the Newark-Columbia route. The route, which resulted in a loss of approximately $945,000 to United Continental, was terminated shortly after Samson's resignation in 2014. Samson subsequently pled guilty to bribery charges. Smisek resigned from United in 2015, along with two other senior officers at the company, following an internal investigation.

The SEC Cease and Desist Order

In the Order, the SEC found that the CEO's actions violated the FCPA's accounting provisions, Sections 13(b)(2)(A) and 13(b)(2)(B). Section 13(b)(2)(A) requires that covered issuers keep books, records and accounts that accurately, fairly and in "reasonable detail" reflect the issuer's transactions and dispositions of assets.[2] The term "records" is defined broadly in the Exchange Act as "accounts, correspondence, memoranda, tapes, disks, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language" and has been interpreted to reach beyond mere financial statements, instead encompassing "virtually any tangible embodiment of information made or kept by an issuer."[3] Section 13(b)(2)(B) mandates that covered issuers maintain a system

Continued on page 3

2. 15 U.S.C. § 78m(b)(2)(A).
3. *See* 15 U.S.C. § 78c(a)(37); *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 748-49 (N.D. Ga. 1983).

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

Continued from page 2

of internal accounting controls that gives "reasonable assurances" of the following: (i) transactions are carried out in accordance with management's authorization; (ii) the recording of transactions enables both financial statements compliant with generally accepted accounting principles ("GAAP") or other applicable criteria and maintenance of asset accountability; (iii) assets can only be accessed in accordance with management authorization; and (iv) regular comparisons between recorded asset accountability and existing assets are made, with appropriate action in case differences are found.[4] The ambiguity of the terms and breadth of the statutory requirement ultimately enable the SEC to adopt broad, hindsight-based interpretations of what levels of detail and assurance it believes would have been reasonable in any particular case.

In this case, the most significant factors in the SEC's evaluation appear to have been the process followed by the company and its management in approving the new route and the alleged improper purpose associated with it. According to the Order, United had no written policy for initiating new flight routes, perhaps

"The case of United is only one of several where the SEC has employed the FCPA's accounting provisions to reach beyond the financial and auditing realm of a company. . . . [R]ecent actions suggest the SEC is casting the net as widely as possible."

bolstering the CEO's belief that his managerial approval sufficed at a time when a much higher value project was at risk. In the absence of a formalized policy, however, the SEC looked to the company's standard practices and discovered that these were not followed. United allegedly neglected to obtain Network Planning Group and Chief Revenue Officer approval for the route, nor did the route undergo several senior United executives' review at a standard marketing meeting. The SEC also found that United's Code of Business Conduct prohibited taking this loss-inducing action to influence decision making by government officials or civil servants, and that the CEO did not apply for a waiver required to disregard the Code

Continued on page 4

4. 15 U.S.C. § 78m(b)(2)(B).

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

Continued from page 3

in United's best interest. The SEC interpreted consistency with these policies to be part of the Section 13(b)(2)(B) requirement of a system of controls allowing transactions only in accordance with management authorization. Moreover, the SEC concluded that Section 13(b)(2)(A) was violated because there was no written request for a waiver of the Code to the Ethics and Compliance Director or the Board of Directors, so that the route's authorization was not reflected accurately, fairly and in reasonable detail in company records. The SEC's Order makes no assertion that United's financial statements were materially inaccurate as a result of the alleged conduct. On the heels of a $2.25 million fine to the U.S. Attorney's Office, United was ordered to pay $2.4 million in SEC penalties.

Growing Reach of the Books and Records Radar

The case of United is only one of several where the SEC has employed the FCPA's accounting provisions to reach beyond the financial and auditing realm of a company. For example, in a 2015 Cease and Desist Order against BHP Billiton Ltd. and BHP Billiton Plc. (collectively "BHPB"), the SEC focused on internal "hospitality applications" used by the company to approve invitations of government officials from various Asian and African countries to the 2008 Olympic Games in Beijing it was sponsoring.[5] Identifying these applications as company records under Section 13(b)(2)(A), the SEC found that these forms did not sufficiently reflect pending commercial dealings and negotiations with such officials and that BHPB's internal controls were by extension also deficient under Section 13(b)(2)(B).[6]

As another example, the D.C. District Court, in a recent decision granting the SEC summary judgment on alleged books and records violations by e-Smart Technologies, Inc., focused more concretely on accurate financial records and reporting but used the lack of current board minutes, a formal employee conflict of interest policy, and communication between outside consultants and staff as evidence of the company's insufficient internal controls under Section 13(b)(2)(B).[7] This broad interpretation of internal controls requirements follows an earlier criminal case in which inaccurate and backdated committee meeting minutes created by an individual defendant were deemed a record under Section 13(b)(2)(A).[8] The court denied the defendant's motion for new trial, in which she requested the jury be instructed that she could only be convicted if she knew the minutes would impact the company's financial statements.[9]

Continued on page 5

5. *In the Matter of BHP Billiton Ltd.*, Exchange Act Release No. 74998, 2, 9 (May 20, 2015).
6. *Id.* at 9.
7. *SEC v. e-Smart Technologies, Inc.*, 82 F. Supp. 3d 97, 109-114 (D. D.C. 2015).
8. *U.S. v. Jensen*, 532 F. Supp. 2d 1187, 1196 (N.D. Cal.2008).
9. *Id.* at 1197-1200.

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

Continued from page 4

Although SEC has historically made statements suggesting a narrower interpretation of the books and records provision,[10] recent actions suggest the SEC is casting the net as widely as possible. In a few instances, courts have pushed back, stating that the mere entry into a non-GAAP recognizable transaction is not sufficient to generate a books and records violation[11] and that an inaccurate report of transactions in a Form 10-K is only sufficient to establish a recordkeeping violation under Section 13(b)(2)(A) but not an entirely lacking system of internal controls under Section 13(b)(2)(B).[12] Given that much FCPA enforcement activity takes place outside the courtroom, however, broad SEC interpretations of the FCPA's accounting provisions remain a genuine concern for issuers.

Implications for Public Issuers

To comply with the FCPA's accounting provisions, internal accounting controls must not only ensure managerial approval of transactions but also maximize the ability to prevent management decisions that fall outside standard business practices and potentially violate internal ethical policies. Despite the potential commercial benefits of flexible, unwritten transaction and asset disposition approval practices, issuers should be on the lookout for risks associated with potential management actions outside of standard channels and consider greater formalization of such practices, such as written policies requiring clear internal procedures and strict compliance, absent delineated circumstances.

Also, companies must be vigilant in creating written documentation of compliance with various internal policies in light of the SEC's willingness to extend Exchange Act books and records violations to records significantly removed from financial statements or associated disclosures. Lastly, although not implicated by this case, companies should also ensure that procedures are implemented and actions documented for transactions and events that require expedited action.

Continued on page 6

10. *See* SEC Release No. 34-17500, *2 (Jan. 29, 1981) ("This provision is intimately related to the requirement for a system of internal accounting controls, and we believe that records which are not relevant to accomplishing the objectives specified in the statute for the system of internal controls are not within the purview of the recordkeeping provision.")
11. *See SEC v. Patel*, 2008 WL 781914, *17-18 (D. N.H. 2008).
12. *See SEC v. Black*, 2008 WL 4394891, *15 (N.D. Ill. 2008).

Failure to Comply with Internal Corporate Processes and Policies May Violate FCPA Accounting Provisions

Continued from page 5

Paul R. Berger

Colby A. Smith

Jonathan R. Tuttle

Ada Fernandez Johnson

Alice N. Barrett

Paul R. Berger, Colby A. Smith, and Jonathan R. Tuttle are partners in the Washington, D.C. office. Ada Fernandez Johnson is a counsel in the Washington, D.C. office. Alice N. Barrett is a law clerk in the Washington, D.C. office. The authors may be reached at prberger@debevoise.com, casmith@debevoise.com, jrtuttle@debevoise.com, afjohnson@debevoise.com, and anbarrett@debevoise.com. Full contact details for each author are available at www.debevoise.com.

Continued on page 7

UK Proposes New Legislation Targeting Proceeds of Crime

The UK's Criminal Finances Bill 2016 (the "Bill") took one step closer to becoming law after its second reading in the House of Commons on October 25, 2016.[1] The Bill targets revenue generated by organised crime and follows a major review by the UK government of its anti-money laundering ("AML") and terrorist financing strategies. Its coming into force will bring significant reforms to the UK's anti money laundering and proceeds of crime legislation.

The Bill introduces a mechanism known as "unexplained wealth orders" ("UWO") which can be made by the High Court, following an application made by a relevant enforcement agency,[2] and require an individual or organisation to explain the origin of their assets, in the event those assets appear to be disproportionate to their known income. Significantly, failure to provide a response will automatically give rise to the presumption that the property is criminal, and thereby recoverable in civil proceedings pursuant to the procedures set out in Part 5 of the Proceeds of Crime Act 2002 ("POCA").

Transparency International has described UWOs as the "most important anti corruption legislation to be passed in the UK in the past 30 years [which will ensure that] the UK is no longer seen as a safe haven for corrupt wealth."[3]

The Current Position

Presently, UK enforcement agencies have two principal routes by which to deal with criminal assets. A criminal confiscation enables the court to order a person found criminally liable to pay to the Treasury (via a Magistrates' Court) a sum equivalent to the value of the benefit received from the relevant criminal conduct. Civil recovery of assets under Part 5 of POCA[4], on the other hand, does not require a criminal conviction, it being sufficient to show that, on the "balance of probabilities,"[5] the property was "obtained through unlawful conduct."[6]

Continued on page 8

1. Criminal Finances Bill (HC Bill 97) ("Bill"), www.publications.parliament.uk/pa/bills/cbill/2016-2017/0097/cbill_2016-20170097_en_1.htm.
2. Section 362A(7) of the Bill defines "enforcement agency" as the National Crime Agency, HMRC, the Financial Conduct Authority, the Serious Fraud Office (the "SFO"), and the Director of Public Prosecutions.
3. http://www.transparency.org.uk/press-releases/transparency-international-response-to-criminal-finances-bill/.
4. Such recovery is currently governed by sections 243 to 288 of POCA.
5. POCA Section 241(3).
6. POCA Section 242.

UK Proposes New Legislation Targeting Proceeds of Crime

Continued from page 7

The use of civil recovery orders, effectively as a means of civilly settling corporate bribery and corruption cases had come in for extensive judicial criticism in the past and should be seen as a means of enforcement that has been superseded by a number of legislative changes (namely, the advent of the "corporate offence" under the Bribery Act 2010 and, most importantly, the advent of DPAs in English law since 2014) and also the expressed intention of the Serious Fraud Office, since 2012, to pursue such matters criminally.

UWOs will not become the default means of recovering criminal assets and an alternative method of punishing those involved in bribery or corruption. Instead, according to the government, the primary use of UWOs will be as an "investigative tool"[7]; they will be used alongside the existing methods available to enforcement agencies, filling the gap between criminal confiscation and civil recovery. Unlike criminal confiscation, UWOs are not contingent on a conviction. UWOs also substantially differ from the civil recovery regime in that they do not require the relevant enforcement agency to prove that the property in question is the instrument or proceed of crime.

Unexplained Wealth Orders

The key aspects of UWOs are set out in Part 1, Chapter 1 of the Bill. This provides that, upon application by an enforcement agency, the High Court may grant a UWO requiring the respondent to provide a statement:

a) setting out the nature and extent of the respondent's interest in the property in respect of which the order is made; and

b) explaining how the respondent obtained the property (including, in particular, how any costs incurred in obtaining it were met).[8]

If a respondent fails to provide a satisfactory explanation of how they acquired the relevant property within a response period set by the High Court, the property will be presumed to be "recoverable" for the purposes of the civil recovery provisions contained within Part 5 of POCA.[9] If the respondent replies within the response period, the law enforcement agency has 30 days to consider the evidence put forward. During this period, the enforcement agency must decide whether to take no further action, begin a civil recovery investigation or apply for a civil recovery order under POCA (section 266).

Continued on page 9

7. Home Office and HM Revenue and Customs: Memorandum on the Criminal Finances Bill and ECHR (November 1, 2016) at paragraph 65.
8. Bill, Section 362A(3).
9. *Id.*, Section 362A(6), 362C.

UK Proposes New Legislation Targeting Proceeds of Crime
Continued from page 8

Under section 362E of the Bill, it is an offence for a respondent to knowingly or recklessly make a statement that is false or misleading. A respondent that does so may receive a prison sentence of no more than two years, a fine, or both.

An interim freezing order may also be granted in respect of the property subject to the UWO application, thereby preventing the property being dissipated while it is subject to the order. An application for an interim freezing order must be made to the High Court at the same time as the application for the UWO, although it may be ancillary to the UWO proceedings.[10]

"[Unexplained Wealth Orders] will not become the default means of recovering criminal assets and an alternative method of punishing those involved in bribery or corruption. Instead, according to the government, the primary use of UWOs will be as an 'investigative tool' . . . ."

Obtaining an Unexplained Wealth Order

To grant a UWO, the High Court must be satisfied that either:

a) there are reasonable grounds to suspect that the respondent is or has been involved in serious crime[11] (either in the United Kingdom or elsewhere) or a person connected with the respondent is or has been so involved;[12] or

b) the respondent is a politically exposed person ("PEP").[13]

In addition, the following requirements must have been met:

c) the value of the property held by the respondent is greater than £100,000; and[14]

d) there are reasonable grounds for suspecting that the known sources of the respondent's lawfully obtained income would have been insufficient for the purposes of enabling the respondent to obtain the property.[15]

Continued on page 10

10. *Id.*, Section 262I.
11. "Serious crime," which is defined as a list of offences as set out in Schedule 1 to the Serious Crime Act 2007, includes drug trafficking, arms trafficking and money laundering.
12. Bill, Section 362B(4)(b).
13. *Id.*, Section 362B(4)(a).
14. *Id.*, Section 362B(2). It does not matter for the purpose of this section whether the respondent obtained the property before or after the coming into force of this section.
15. *Id.*, Section 362B(3).

Analysis

While law enforcement agencies and non-governmental organisations unsurprisingly view the proposed introduction of UWOs positively, concerns regarding basic legal rights have meant that the Bill has been cautiously received by the legal profession.

Self-Incrimination

As with existing "section 2" powers granted to the SFO under the Criminal Justice Act 1987 and provisions relating to the use of evidence provided in response to a disclosure order under section 359 of POCA, any statement provided by the respondent to a UWO may be used in evidence but not in the course of any criminal proceedings against the subject of the UWO.[16] As a result, an individual's rights protecting against self-incrimination should remain protected.

Lawyers will, however, need to take care when advising clients how to respond to a UWO. Given the presumption of guilt that arises from a refusal to comply with an order, lawyers will likely advise their client to comply with a UWO. Even where a lawyer knows or suspects that the asset in question was obtained with the proceeds of crime, a carefully worded response would probably be in the best interests of the client and preferable to non-compliance.[17]

In order to minimise the risk of the same forfeiture penalty that would result from non-compliance, lawyers will need to ensure that any response to a UWO does not disclose more information than is strictly necessary to comply with the order. At the same time, however, care will need to be taken not to mislead the court and fall afoul of section 362E of the Bill which criminalises false or misleading statements. In practice, this may be a difficult balancing act to achieve.

Continued on page 11

16. *Id.*, Section 362F(1). This is subject to certain exceptions, as set out in section 362F(2).

17. Advice to the contrary may, in any event, be contrary to the SRA Code of Conduct (the "Code"). Outcome (5.2) of the Code prohibits a lawyer from being complicit in another person misleading the court. Knowing or suspecting that an individual obtained an asset from the proceeds of crime and then advising them not to comply with a UWO in order to escape liability may be interpreted as breaching this requirement. Furthermore, Indicative Behaviour (5.1) of the Code states that the Outcomes in chapter 5 of the Code (including Outcome (5.1) may be achieved by advising clients to comply with court orders made against them, and advising them of the consequences of failing to comply.

Reverse Burden of Proof

A further concern is the reversal of the burden of proof, which runs contrary to the presumption of innocence. Members of Parliament, particularly those with legal training, raised this issue in parliamentary debates on the Bill but concluded that reversing the burden was a proportionate response to the issue at stake: the public interest in the prevention and detection of crime.[18]

In a memorandum published by the Home Office and HMRC on the Bill's compatibility with the European Convention on Human Rights, the government emphasised that the effect of the UWO is limited and that it is not the mechanism itself by which the property is recovered, noting that "it is merely an investigative tool not a property seizing power."[19] The memorandum goes on to say that "[t]he UWO is intended to provide a mechanism to gather evidence in full, and the rebuttable presumption is primarily intended to incentivise cooperation with the UWO and the ongoing investigation."[20]

The fact that the presumption is rebuttable means that a final determination regarding the legitimacy of the ownership of the assets in question would not be made until a court ordered recovery at a subsequent hearing, at which point the respondent would be entitled to advance evidence to rebut the presumption. Nevertheless, the potential for the seizure of private property is a serious and onerous measure. It remains to be seen whether there are sufficient safeguards in place to justify a reversal of the burden of proof.

PEPs

The definition of a PEP in section 362B(7) is "an individual who is, or has been, entrusted with prominent public functions by an international organisation or by a State other than the United Kingdom or another EEA State." This definition expands that used in the Money Laundering Regulations 2007 ("2007 Regulations") as it includes family members and close associates. The provision appears to respond to a perceived need to address the issue of proceeds of crime overseas being laundered in the UK, and brings the definition in line with the wording in the Fourth European Anti-Money Laundering Directive ("the Directive"), which is due to be implemented into UK law by June 26, 2017. Unlike the Directive, however, the Bill's definition of a PEP does not extend to domestic PEPs, only to foreign PEPs.

Continued on page 12

18. See, for example, the comments by Richard Arkless (Dumfries and Galloway) (SNP) HC Deb (October 25, 2016), vol. 616, col 212; and James Berry (Kingston and Surbiton) (Cons) HC Deb (October 25, 2016), vol. 616, col 217, available at https://hansard.parliament.uk/commons/2016-10-25/debates/9E615B36-9222-45BF-BD9D-46D503D7F591/CriminalFinancesBill.
19. Home Office and HM Revenue and Customs: Memorandum on the Criminal Finances Bill and ECHR (November 1, 2016), at paragraph 65.
20. *Id.*

Unclear Parameters

Certain parameters regarding the making of UWOs remain unclear. No guidance has yet been provided, for example, on: (a) the evidence that would be sufficient to establish the reasonable suspicion that the respondent has been involved in a serious crime;[21] (b) the evidence required to establish the "reasonable grounds for suspecting" that the property held by a respondent exceeds the respondent's known sources of income;[22] (c) what amounts to a "reasonable excuse" under section 362C(1) for failing to comply with a UWO; and (d) what sort of documents might be requested or necessary in order to demonstrate assets were legally obtained.

Such points will ultimately need to be clarified by the courts, but until this happens, respondents to a UWO application will potentially face considerable uncertainty.

Conclusion

The Bill is a sign of the UK government's appetite to tackle money laundering and perceptions that the UK, and in particular its real estate market, has become a safe haven for criminal assets. UWOs would provide a powerful investigative tool that will complement, rather than replace, other proceeds of crime legislation already in place, including civil recovery orders. Significantly, UWOs would have retrospective effect and could be issued in respect of property acquired before the Bill came into law. The date of the Bill's third and final reading in the House of Commons is yet to be announced, but it is hoped that this will clarify some of the more ambiguous sections highlighted above before the Bill passes through the House of Lords and is sent to the Queen for royal assent.

Karolos Seeger

Alex Parker

Ceri Chave

Edward Pearson

Karolos Seeger is a partner in the London office. Alex Parker is a counsel in the London office. Ceri Chave and Edward Pearson are associates in the London office. The authors may be reached at kseeger@debevoise.com, aparker@debevoise.com, cchave@debevoise.com, and epearson@debevoise.com. Full contact details for each author are available at www.debevoise.com.

21. Pursuant to section 362B(4)(b) of the Bill.
22. Pursuant to section 362(B)(3) of the Bill.

FCPA Update

FCPA Update is a publication of
Debevoise & Plimpton LLP

919 Third Avenue
New York, New York 10022
+1 212 909 6000
www.debevoise.com

Washington, D.C.
+1 202 383 8000

London
+44 20 7786 9000

Paris
+33 1 40 73 12 12

Frankfurt
+49 69 2097 5000

Moscow
+7 495 956 3858

Hong Kong
+852 2160 9800

Shanghai
+86 21 5047 1800

Tokyo
+81 3 4570 6680

Paul R. Berger
Co-Editor-in-Chief
+1 202 383 8090
prberger@debevoise.com

Sean Hecker
Co-Editor-in-Chief
+1 212 909 6052
shecker@debevoise.com

Andrew M. Levine
Co-Editor-in-Chief
+1 212 909 6069
amlevine@debevoise.com

Sarah Coyne
Co-Editor-in-Chief
+1 212 909 6968
scoyne@debevoise.com

Philip Rohlik
Co-Executive Editor
+852 2160 9856
prohlik@debevoise.com

Bruce E. Yannett
Co-Editor-in-Chief
+1 212 909 6495
beyannett@debevoise.com

Karolos Seeger
Co-Editor-in-Chief
+44 20 7786 9042
kseeger@debevoise.com

David A. O'Neil
Co-Editor-in-Chief
+1 202 383 8040
daoneil@debevoise.com

Erich O. Grosz
Co-Executive Editor
+1 212 909 6808
eogrosz@debevoise.com

Jane Shvets
Deputy Executive Editor
+44 20 7786 9163
jshvets@debevoise.com

Please address inquiries regarding topics covered in this publication to the editors.

Please note:
The URLs in FCPA Update are provided with hyperlinks so as to enable readers to gain easy access to cited materials.