WHITE & CASE

Global investigations: reading the signals

As the global economy recovers, how will regulators respond? Experts provide perspectives on trends in regulatory and corporate investigations

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Global trends in regulation

In the wake of the financial crisis, there has been a sustained rise in the number and variety of investigations and enforcement actions taken by regulatory authorities globally. Multinational corporations and financial institutions are now more likely than ever before to find themselves subject to cross-border investigations conducted in parallel by multiple authorities

Regulatory authorities around the world are continuing to investigate and prosecute business conduct aggressively and to impose record-setting penalties in the process. There is no sign that this trend will abate. Quite the contrary. And, while US authorities remain in the vanguard of such initiatives, now more than ever non-US authorities can be expected not only to cooperate with and facilitate US enforcement initiatives, but also to pursue their own criminal or regulatory investigations and to exact their own significant penalties.

This trend of global scrutiny toward and enforcement against certain business conduct is facilitated by the broad jurisdiction of anticorruption laws such as the US Foreign Corrupt Practices Act and the UK Bribery Act as well as various antitrust, sanctions and anti-money laundering regimes. Enforcement authorities, particularly in the United States, have used such laws and accompanying legal doctrines to prosecute corporate and individual misconduct in far-flung markets that may have little apparent nexus, for example, to the United States.

For this report, we invited a number of experts to provide different perspectives on this changing regulatory landscape and what it means for business. The articles consider what the current challenges are, how things might develop in the future, and what the implications are for financial institutions, corporates and their officers, directors and employees around the globe. We also look at the US and EU sanctions levied as a result of the crisis in Ukraine.

We hope that you enjoy this report, and we welcome the opportunity to discuss these subjects with you in greater depth. ■

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In no uncertain terms

Regulatory uncertainty rather than complexity is the biggest challenge facing general counsel of multinationals

François Garnier

Chief Counsel International Platform, Pfizer

Uncertainty can be the biggest regulatory challenge facing the general counsel of multinational companies. Give me enough certainty—clear rules and guidance—and I can structure my operations for success. But when regulations are unclear or unstable, it can be almost impossible to develop reliable compliance or business strategies.

As the Chief Counsel International Platform at Pfizer, I'm familiar with the challenges posed by regulatory complexity. The pharmaceutical industry is highly regulated, and Pfizer has operations in every major trading country around the globe. Each of these countries has its own regulatory framework that can include complex and multi layered systems of controls. Regions within countries may also be subject to different regulations. And antitrust and anticorruption laws—such as the US Foreign Corrupt Practices Act and the UK Bribery Act—have extraterritorial jurisdiction and thus apply to virtually every company trading internationally.

We have to ensure that we're doing the right things at the regional, national and global levels. And we have to be as vigilant with partners as we are with ourselves—vendors and providers must undergo the same checks and controls that we apply internally, and they must understand that Pfizer has zero tolerance for non compliance.

It's possible to overdo it. Excessive controls can slow business down and stifle innovation. It is important to find the right balance. But uncertainty is a bigger problem still. As long as I know what is required of me, I can deal with even the most stringent requirements. It may be costly, introducing complex and excessive bureaucracy to the company, but these challenges are manageable—and they pale in comparison to uncertainty.

Emerging markets pose the greatest challenges. Regulations in these countries can be ambiguous, and guidance from rule makers can be vague or non existent. Even worse, regulations may change frequently and unexpectedly in these countries, leaving companies unsure how long their compliance strategies will be effective or relevant.

Separation of powers and due process are critical in the regulatory context, as elsewhere. Authorities have the power to grant market access and regulate operations, but in many jurisdictions they also act as police and judge. I would like to see a better balance of power between the regulator and industry, but in many cases this will depend on the local judicial authority.

There's reason to believe that regulatory activity will increase across industries and countries in the foreseeable future. If that happens, regulations will play an increasing role in setting competitive conditions and determining opportunities for growth. In such an environment, the need for clarity and consistency is all the more important. Regulatory uncertainty not only makes it difficult for companies to do business, it reduces their ability to comply. That's a loss for businesses, regulators and society in general. ■

$216bn

Estimate of regulatory costs imposed on US economy by the federal government in 2012

Source: American Action Forum

£27.4bn

Estimate of cost to UK economy of top 100 EU laws

Source: Open Europe

> **Regulatory uncertainty not only makes it difficult for companies to do business, it reduces their ability to comply**

Scoring a common goal: cooperation between agencies

Antitrust agencies are waking up to the idea that fighting bribery is essential to the maintenance of competitive markets

David Vascott

Editor, *Global Investigations Review*

It might seem obvious that corruption hurts competition. Yet historically, anticorruption and antitrust agencies in most countries rarely work together. That may be about to change.

Discussions at the Organisation for Economic Co-operation and Development (OECD) 2014 Forum on Competition suggest that antitrust agencies increasingly recognize that they need to play their part in eradicating corruption. Several speakers called for greater cooperation with their anticorruption counterparts—emphasizing, for example, that it is impossible to maintain competitive markets unless bribery laws are enforced.

Obiageli Ezekwesili, co-founder of Transparency International, an anticorruption organization, summed up the emerging consensus: "Everything that corruption likes, competition dislikes," she said. "Corruption wants to do things in a clandestine environment, but…the more transparency, the greater the competition. Corruption does not care for value for money, but competition is about value for money. Corruption does not care about the interests of the greater majority, but competition cares about the interests of the greater majority."

The Forum, which is held every year at the OECD's Paris headquarters, convenes national representatives from competition agencies around the world. As such, the event is a bellwether for developments in the field.

The root of the problem is the fact that agencies often do not share information, even when doing so would enable them to achieve common objectives. Most antitrust agencies carry out dawn raids to investigate antitrust violations. Information discovered during their investigations could often be evidence of corruption, but antitrust investigators may not be trained to recognize it as such. In addition, it may be difficult to share findings across agencies for both institutional reasons and other factors such as different standards of evidence gathering.

It is unlikely that we will see mergers between antitrust and anticorruption agencies due to the institutional and legal obstacles that would need to be overcome. However, the recent signing of a memorandum of understanding between the UK's Serious Fraud Office and the Competition Markets Authority detailing mutual cooperation in criminal cartel proceedings may be a sign of things to come. Greater cooperation—from gathering evidence and sharing information to extending cartel leniency agreements to cover corruption issues—may be both desirable and achievable for authorities.

This could have significant implications for business. If competition enforcers carrying out a dawn raid are also on the lookout for potential corruption issues in the target company, that company's counsel may find they have an entirely new front to defend—one that potentially ramifies far beyond the immediate antitrust issue. With the extraterritorial reach of the US Foreign Corrupt Practices Act, the UK Bribery Act and other far-reaching national bribery laws, an investigation launched on the back of a domestic antitrust issue could quite foreseeably open up a Pandora's box of cross-border, anticorruption probes. ■

"The root of the problem is the fact that agencies often do not share information, even when doing so would enable them to achieve common objectives

The inexorable rise of EU fines

Tough EU financial penalties alone may not be acting as an effective deterrent to anticompetitive behavior, and are instead having other unwelcome impacts


© Tim Graham / Getty Images

EU authorities use the size of fines to show they are doing a good job

James Killick, Partner, White & Case, Brussels

The European Union last year handed down record fines for anticompetitive behavior totalling €1.9 billion or $2 billion. That's more than double the fines imposed by antitrust authorities in the United States and ten times more than those in China.

In the last five years, the EU has imposed antitrust fines of more than €8.6 billion in ever-increasing amounts and has the ability to levy fines of up to ten per cent of a company's—or its group's—annual global turnover.

This year looks set to be another bumper year with ongoing probes into the auto parts industry, among others.

The scope and targeting of the EU's fining policy is also being expanded. This year, for the first time, a private equity fund was fined just over €37 million by virtue of its controlling stake of a suspected cartelist in the power cables case, without there being any evidence that it was aware of any infringement.

In what is a clear warning to private equity firms, European Commissioner for Competition Joaquín Almunia highlighted "the responsibility of groups of companies up to the highest level of the corporate structure to make sure that they fully comply with competition rules."

"These responsibilities are the same for investment companies who should take a careful look at the compliance culture of the companies they invest in," he said.

In response to criticism, EU chiefs continually insist their regime of tough financial penalties acts as a deterrent. The bigger the fine, the bigger the deterrent, the story goes.

But not everyone is convinced. In a 2013 paper entitled *Antitrust fines in times of crisis*, Massimo Motta, now chief economist at the EU's Directorate-General for Competition, concluded that "even very large corporate fines may not be able to achieve deterrence". Indeed, cartels continue to form, and each year the EU launches a number of new investigations, ultimately imposing large fines on a number of companies.

"EU authorities have a tendency to use the size of fines as a benchmark to show they are doing a good job," says James Killick, a competition law partner at White & Case in Brussels. "The underlying idea is that the best way to get people to comply is to fine their companies increasing amounts of money. On top of that, each successive competition commissioner wants to show they are more successful than the previous one, so there is a tendency to increase fines."

€8.6bn

Amount of EU antitrust fines in last five years

Source:
European Commission

"But the outcome is that competition fines are far higher and disproportionate compared with those imposed for other regulatory breaches, such as health & safety, violation of consumer protection rules or major environmental damage, for example."

Boris Kasten, head of competition law at global elevator and escalator group Schindler, agrees. "It's a race to the top in terms of EU fines, without much reflection on whether this alone, without reflecting companies' specific compliance systems, really serves as a deterrent," he says. "There may even be an international trend to impose giant fines on corporations as a sort of competition among enforcement agencies."

That said, in the United States, which has a long history of antitrust enforcement, fines are much lower due to more sophisticated types of punishment, involving fines and criminal sanctions against the individuals guilty of violations, according to Dr Kasten.

Individuals who fix prices or allocate markets as a way of ensuring business outcomes, for example, which may not actually be in the company's interest, are subject to criminal sanctions under national law in the United States, the UK and several other EU member states. "A fine of double a manager's annual earnings or possible incarceration would act as a deterrent," he says.

Large EU fines on companies also impact economic growth. Research by Oxford Economics shows that the most likely resulting scenario is the company will reduce the amount it spends on investment. This will generally mean fewer jobs are created within that company.

Firms will also purchase fewer inputs from their suppliers who, in turn, will employ fewer people. And these suppliers will themselves purchase less from their own suppliers, and so on, with additional effects on potential employment and household spending.

Therefore, a large fine on cartel participants will have a knock-on effect across the economy as a

Reading the signals

Antitrust compliance measures

With competitors

- Don't discuss prices or sales
- Don't discuss rebates, discounts or other pricing terms
- Don't discuss production capacities, investments or stocks
- Don't discuss or engage in concerted action
- Don't discuss customers or suppliers
- Don't discuss marketing
- Don't exchange sensitive business data
- **Always be prudent**

In trade association meetings

- Obey the same rules
- **If others break the rules, make an objection and leave the meeting**

With customers and suppliers

- Don't terminate supply or distribution contracts without first checking with the legal department
- Don't force customers to maintain resale prices or respect set margins
- Don't restrict where and to whom your customers may sell
- Don't require a customer not to buy competing goods

whole, also impacting firms and workers who were not involved in the original offense.

According to Oxford Economics, a €250 million fine on a European manufacturing firm could result in potential employment losses across a national economy of more than 2,000 jobs.

However, despite imposing such high fines, the EU system does not afford companies the usual criminal due process guarantees.

"The same officials act as prosecutor, investigator, judge and ultimately jury, deciding whether you're guilty and how much you should be punished. I'm not saying that the officials don't try to do their job honorably, but they have too many inconsistent roles," says Mr Killick. "And the final decision is taken by a political body that is sensitive about whether the press portray them as tough and effective."

Dr Kasten adds: "Separation of powers is lacking, and we know from history that this tends to lead to flawed decisions. This is not to say that the European Commission deliberately makes incorrect decisions, but due to human nature, you cannot rule out prosecutorial bias in the Commission's decisions. There are no appropriate checks and balances."

In addition, the appeal process before the EU Court of Justice in Luxembourg is inadequate, he says. "It is clearly flawed because there is no hearing of witnesses and no full review by the court. The court in Luxembourg is just engaged in a plausibility check."

In the current environment, it is even more critical for companies to embed a robust compliance program.

Dr Kasten recommends the Antitrust Compliance Toolkit compiled by the International Chamber of Commerce, which, if implemented, would show a company or corporation's strong commitment to implementing a robust and credible compliance program.

Before imposing a heavy fine, he urges the EU to take into account whether a company has introduced an appropriate compliance program, arguing that such a compliance defense should allow for smarter and more rational, balanced sanctions.

Trade associations and consultancies should also consider compliance programs to ensure their clients stay on the right side of antitrust rules. Swiss consultancy firm AC Treuhand is currently battling against a fine imposed on it by the Commission for facilitating a cartel in the chemical industry despite not being active in the market itself.

"If an organization has engaged in compliance to the maximum degree, then it makes little sense in terms of general prevention to still fine the company but take no action against guilty individuals," Dr Kasten says. "Paradoxically, the EU Commission and courts have begun to argue that parent companies should be liable precisely because of parental crime prevention programs, as their existence showed influence on group companies. Instead, the emphasis should be on the individual if you can show they have been properly trained in compliance, but still choose to break the rules."

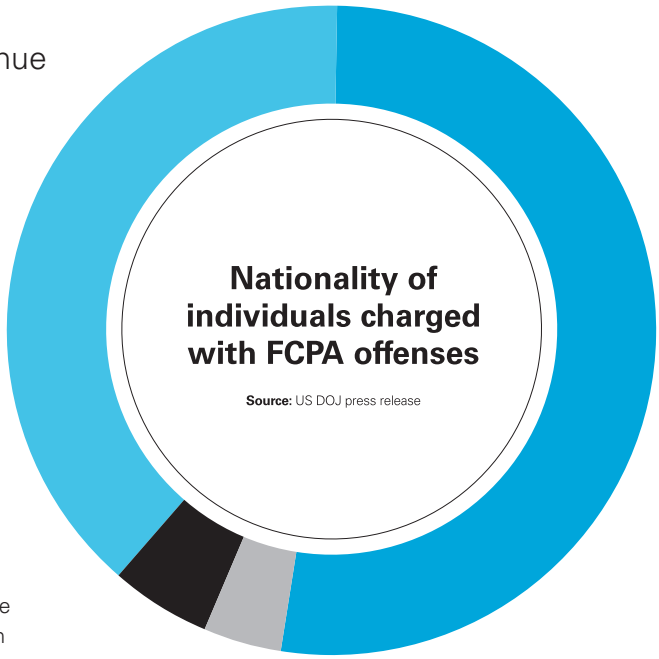
Commercial litigation partner Charles Balmain adds: "I think the EU should recognize when companies have really done a proper job in trying to get their workforce to respect the rules. There should be a lot more focus on the individual who has done something wrong. There is now criminal law at a national level, which is a way of making the punishment fit the crime when it is the individual who was at fault."

The appointment of the new European Commission president and team of commissioners offers an opportunity for reform. As Dr Kasten concludes: "Hope rests with the new Commission taking notice of what research clearly shows—the present system of giant corporate fines while disregarding compliance within organizations and the guilt of individual perpetrators is not achieving the desired level of deterrence." ■

> **"The EU should recognize when companies have done a proper job in trying to get their workforce to respect the rules**
>
> Charles Balmain, Partner, White & Case, London

The long arm of the law: exporting US justice

As individual jail terms and corporate fines continue to increase, many companies and executives outside the United States are left wondering: How are US laws able to reach so far outside US borders? The United States has some fundamental legal principles that can allow its enforcement authorities to apply its laws well beyond US borders. White & Case's White Collar team explains



In recent years, the press has been full of reports of non-US companies being investigated and, at times, prosecuted by enforcement authorities in the United States for a host of alleged violations of US law. Individuals, too, have been charged, extradited and gone to jail in the United States, all without ever setting foot in the United States during the alleged misconduct.

US enforcement authorities are aggressively interpreting and applying US criminal laws to companies and individuals outside the United States, including for conduct with little apparent nexus with the United States. Exposure to potential violations of US law can arise from a number of circumstances, and it is more critical than ever to identify and mitigate those risks. For example, US regulatory and enforcement officials often take the position that the mere transit of emails through the United States - sent from one person outside the United States to another outside the United States - is enough to reach the conduct required under US criminal law.

Similarly, US authorities may assert that transit of money through the United States on its way from one non-US location to another non-US location is enough to create US criminal jurisdiction. This application of US criminal law can result in significant fines and penalties, including imprisonment.

Given the potentially long reach of US law, non-US companies and individuals should manage their legal risk in advance of any potential issues. One of the best ways to address these risks is regularly undertaking risk assessments to determine where there may be exposure to US laws. Another is to create and implement appropriate compliance policies and procedures to conduct transactions in accordance with all applicable laws. Once appropriate policies and procedures are in place, relevant personnel should be trained on a regular basis, including on changes in the law and emerging risk areas.

> **US enforcement authorities know no borders in their pursuit of illegally obtained funds**

Reading the signals

The reach of US law

- Any communication or movement of funds in the US may be sufficient to create US jurisdiction
- Money transiting through the US may be sufficient to create jurisdiction
- US law may apply to the conduct of US citizens outside of the US. See also "US sanctions programs" on page 16 for further definition of a "US person"
- A parent company can potentially be liable for the acts of its subsidiary if the latter acted on its behalf
- US law may apply to acts outside the US of a non-US agent of a company or individual subject to US jurisdiction
- A coconspirator may be liable for the acts of its conspirator

How US laws can apply

MEANS OR INSTRUMENTALITY OF INTERSTATE COMMERCE

Many US laws—including the Foreign Corrupt Practices Act (FCPA) in certain circumstances and various antifraud statutes—may establish jurisdiction over a crime whenever it involves the use of any "means or instrumentality of interstate or foreign commerce." The term is broadly defined by US authorities and may cover any communication or movement that crosses state or international borders, including wire transfers, emails, phone calls, mail and travel. Given the reach of US commerce, from free email servers to correspondent banks that clear US dollars for non-US based banks, such a broad definition can significantly increase the reach of US law. Furthermore, according to US authorities, a defendant company or individual need not use the means or instrumentality of interstate commerce themselves—it may be enough for them to have "caused" the use, such as an instruction being sent to one person, who then forwards it to another, through email servers in the United States.

CONSPIRACY

Conspiracy law may subject non-US companies or individuals who have not committed an act within the United States to US criminal jurisdiction. Under long established principles of criminal liability, a conspirator may be liable for a coconspirator's acts, as well as for any "reasonably foreseeable" offenses committed by a coconspirator. If the United States can establish jurisdiction over a single conspirator, it may have jurisdiction over all conspirators, whether companies or individuals, wherever they may be found.

In certain circumstances, a conspirator need not have participated in or even known about the underlying criminal offense committed by a coconspirator to be liable. Moreover, unlike conspiracy law in some other countries, under US criminal law, a company can "conspire" with its employees, so corporate crime in the United States may result in a prosecutable conspiracy.

AGENT LIABILITY

A company or an individual also may be prosecuted under some US laws, if the company or individual is found to have acted as the "agent" of a company or individual that falls under US jurisdiction. For example, a Japanese trading company was recently prosecuted for violating the FCPA's anti-bribery provisions as the "agent" of a US company, even though the trading company did not act within the United States. A company potentially also may be liable for third parties' actions if those third parties acted on the company's behalf and for the company's benefit. Similarly, under the principle of *respondeat superior*, a company employee who is acting within the scope of his or her employment, and for the benefit of the company, is considered an agent of the company. If they commit a crime connected to their employment, the company may be criminally liable as well.

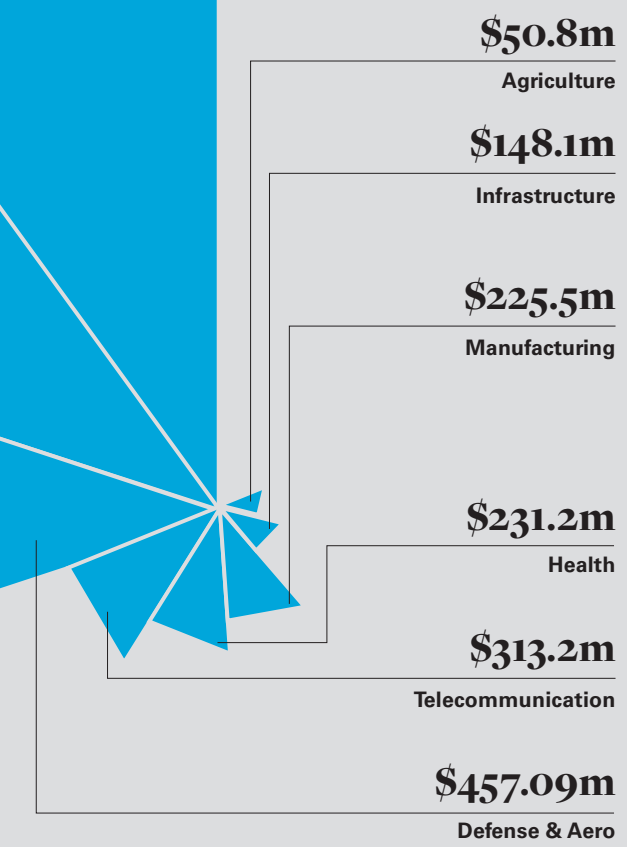
"Transit of money through the United States on the way from one non-US location to another non-US location may be enough to create US criminal jurisdiction

"PIERCING THE VEIL"

A company may be liable for another's conduct under the corporate liability principles of "alter ego" or "piercing the veil." For example, a parent company may be liable for its subsidiary's acts if it can be shown that the subsidiary was acting as the "alter ego"—or under the control of—the parent. If a subsidiary outside the United States is determined to be an "alter ego" of the parent, US authorities may be able to "pierce the veil" of legal separation between the companies, and, if so, the foreign company's actions can be treated as if they were committed by the US company. Once an alter ego relationship is shown to exist, either in general or in a specific instance, the subsidiary's conduct and knowledge may be attributed to the parent.

FCPA penalty by sector

Source: DOJ, SEC, FBI, Raconteur



FOLLOWING THE MONEY: MONEY LAUNDERING AND SANCTIONS

US law makes it a criminal offense to engage in or attempt to engage in a financial transaction involving funds that are known to be the proceeds of certain unlawful activities, or to engage in a financial transaction that provides funds for the commission of a crime (such as terrorist financing or sending a bribe payment). This offense is called "money laundering," and non-US corporations and foreign nationals may be subject to prosecution under US federal anti-money laundering statutes if they are involved in the transfer or attempted transfer of illegally obtained funds or funds used to further criminal activity.

Money laundering offenses can be as serious as the underlying offenses they promote. Each financial transaction can be considered a separate offense and is punishable by substantial fines and possible imprisonment. Additionally, funds and other property involved in money laundering may be frozen or seized by US enforcement authorities, or subject to forfeiture.

In prosecuting money laundering offenses, the US Department of Justice takes the position that jurisdiction exists over a financial transaction if the laundering is completed by a US citizen anywhere in the world, or by a foreign national or non-US corporation if the criminal conduct occurs in part in the United States—even if the foreign individual or company never themselves took an action in the United States, or intended for an act to occur there.

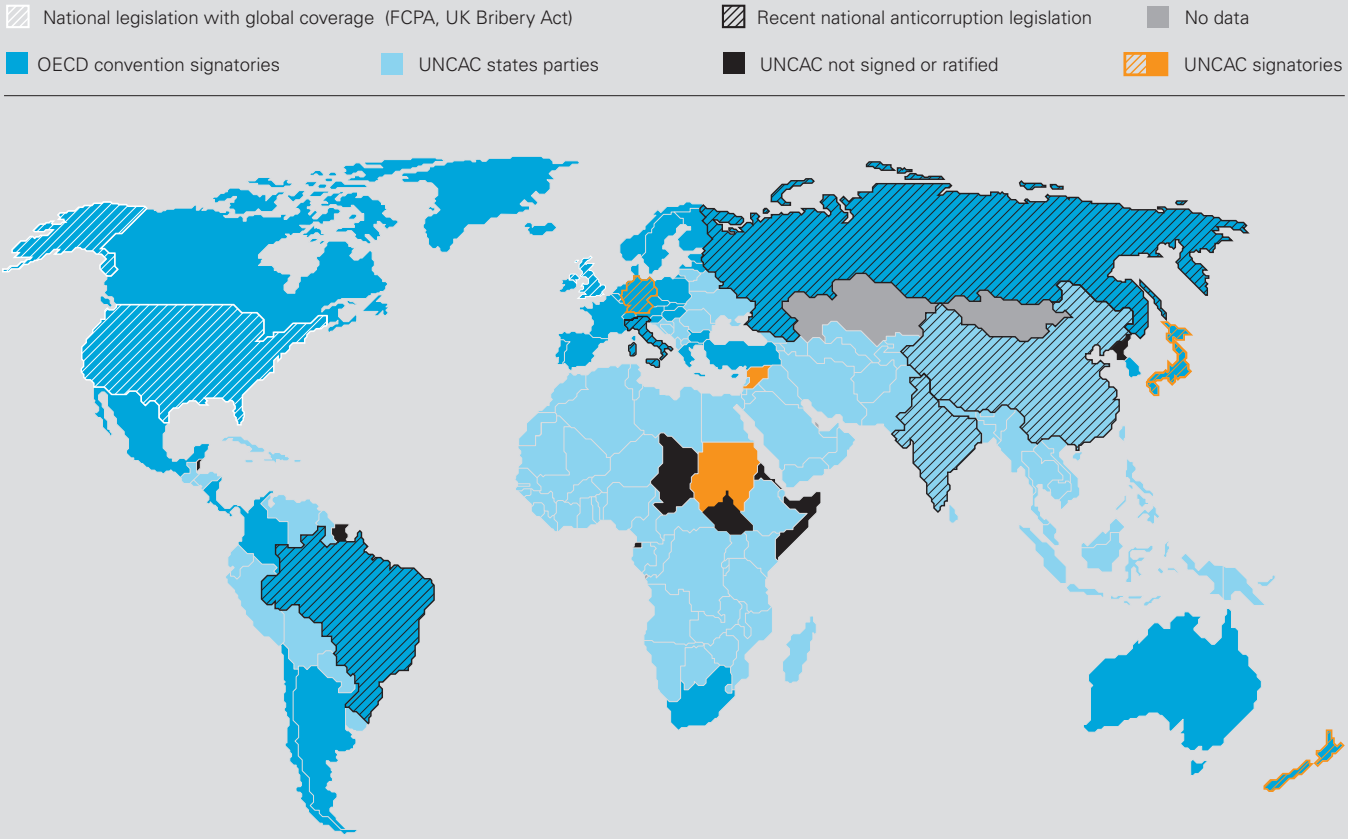
This broad jurisdiction can greatly expand the reach of the US money laundering statutes. For example, US corporations and individuals potentially may be prosecuted for money laundering offenses involving financial transactions that occur wholly outside the United States. US courts have held that the financial transaction requirement is satisfied for a wholly foreign transaction if the defendant's conduct "affected" foreign commerce with the US—such as in antitrust matters. Virtually every dollar denominated transaction potentially implicates US commerce with other nations. While there does need to be an actual US nexus for money laundering laws to apply—the dollars being cleared through a US correspondent bank, for example—and there are dollar-denominated transactions that have no such tie, US enforcement authorities increasingly operate on the assumption (unless convinced otherwise) that they have jurisdiction for such offenses whenever a suspect transaction is denominated in US dollars.

The jurisdiction potentially created by clearing US dollars through a US bank can also significantly extend the reach of US sanctions laws. Sanctions can prohibit or restrict doing business with countries (such as Cuba, Sudan, and Iran), individuals or companies referred to as "specially designated nationals" or "SDNs," which are 'blocked' parties subject to a US asset freeze, and entities placed on the "Sectoral Sanctions Identifications List" (SSI List), as in the case of the Ukraine-related sectoral sanctions. Sanctions regimes typically cover all "US persons," but what qualifies as a US person may change from one sanctions regime to the next, as each set of sanctions varies slightly. Generally, it includes any US citizen or permanent resident and any US company, wherever they are in the world, as well as any person physically in the United States. In addition, in certain instances US sanctions may reach non-US subsidiaries of US companies. This may mean that the clearing of dollars through a US bank may be enough to create US jurisdiction over subject transactions.

The location of funds outside the United States does not necessarily mean they are beyond the reach of US enforcement authorities. Under US law, the proceeds of criminal offenses—including some offenses that occur entirely overseas—may be subject to forfeiture and may be frozen and eventually seized by US authorities through forfeiture actions initiated in US courts. With a judgment of forfeiture issued by a US court in hand, US authorities may be able to freeze not only funds located in US bank accounts, but also funds deposited in foreign bank accounts in view of the increasing cooperation among and between enforcement authorities in different countries. ■

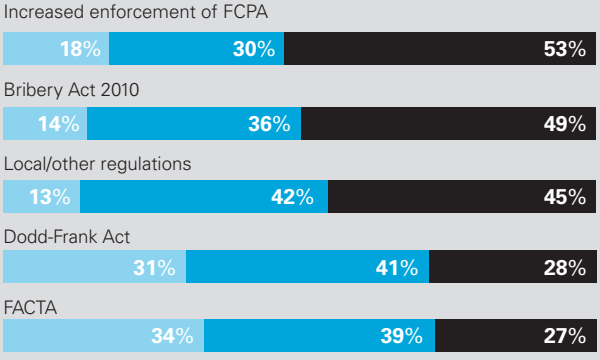
Global investigations legislation & enforcement

Anticorruption legislation



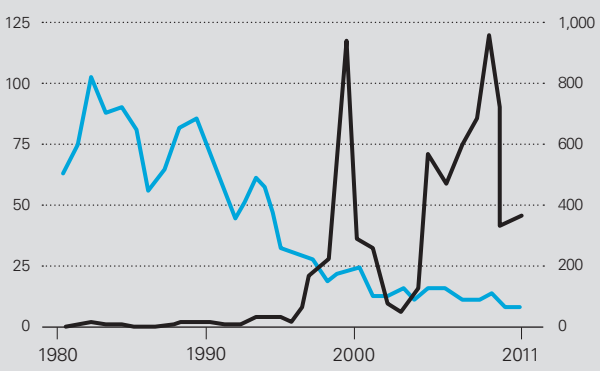
Source: 2014 Business Anti-Corruption Portal

Impact of anticorruption regulations on company policies & procedures



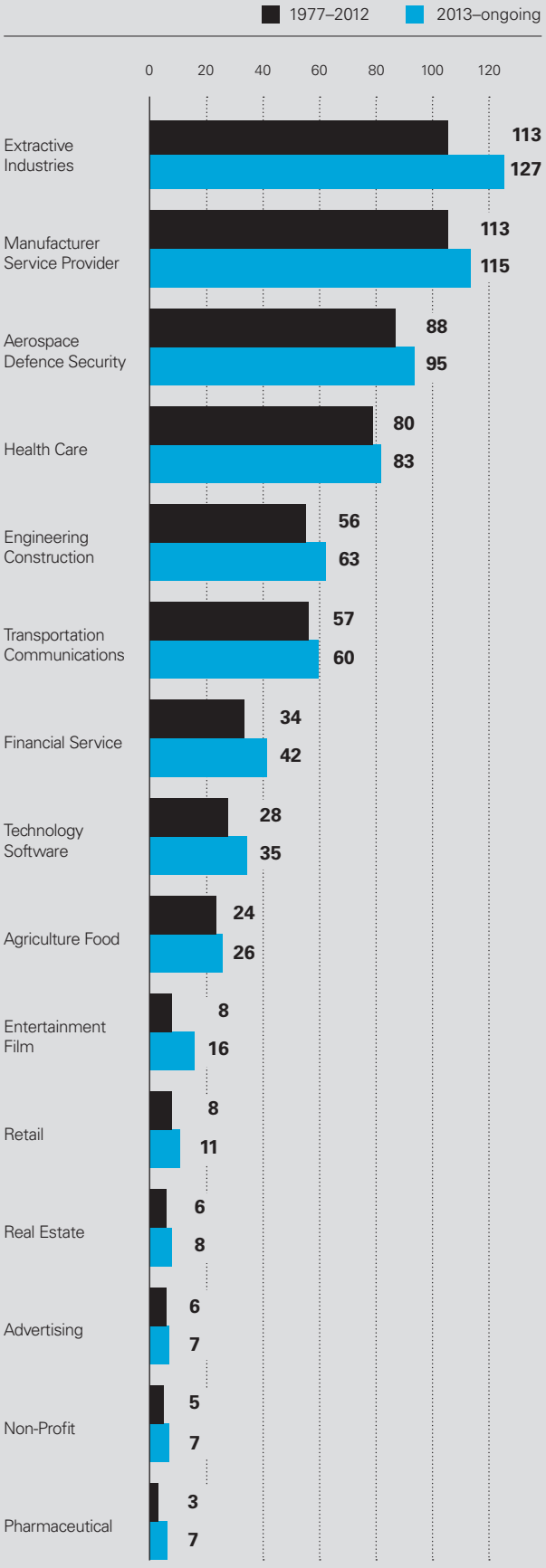
Source: State of Anti-Corruption compliance survey, Dow Jones, 2013

Corporate-cartel fines imposed by the US Department of Justice



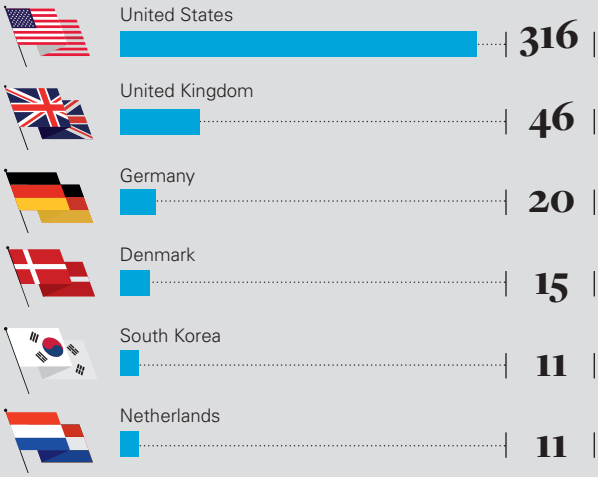
Source: US Department of Justice: The Economist

Total US and non-US bribery enforcement actions by industry 1977–2013



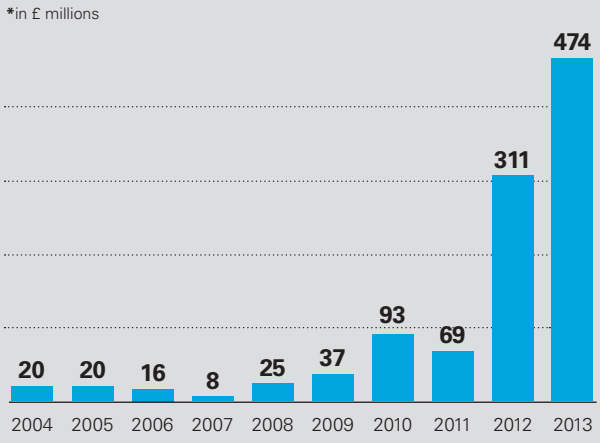
Source: 2014 Business Anti-Corruption Portal

Foreign bribery enforcement actions by country



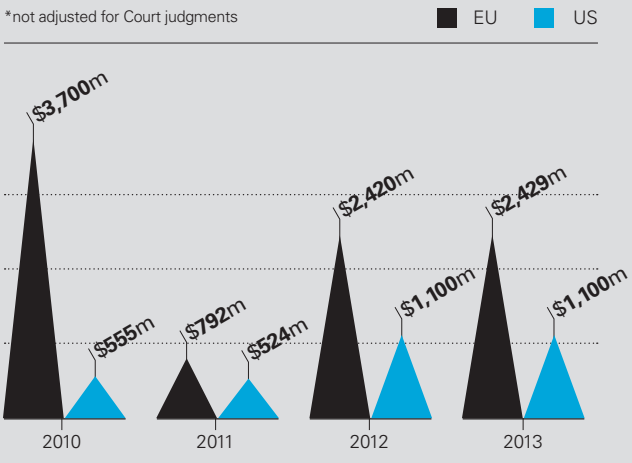
Source: TRACE International: Global Enforcement Report 2013

FSA and FCA fines



Source: Bloomberg FCA, FSA

Criminal anti-trust fines imposed by EU Commission* vs. US Department of Justice



Source: EC / DOJ / Raconteur

Challenging sanctions designations: politics and the judiciary collide

Given the potential impact of political sanctions, it makes sense to ask if there is anything designees can do to challenge the decision to impose sanctions on them. White & Case's EU and US sanctions teams provide some details about the potential for challenging an asset freeze designation in Europe and the United States

United Nations Security Council (UNSC) hold meeting, New York

© Andrew Burton/Getty Images

EU and US restrictions imposed in response to the Ukraine crisis serve as a reminder that sanctions can materialize unexpectedly and expand rapidly. Their effects deliberately extend beyond the designated organizations and individuals themselves, presenting challenges for the entities with which they do business and often for nations and the global business community in general. Given the potential impact of political sanctions, it makes sense to ask if there is anything designees can do to challenge the decision to impose sanctions on them.

In both Europe and the United States, judicial recourse is available to enable organizations and individuals to challenge their designations, but the processes differ depending on which body issued the sanctions. Recent cases in Europe and to a limited extent, the United States, suggest that it is possible to mount a successful challenge. It's never easy, particularly because the processes for designating sanctions targets is conducted in secret, often using classified information that is not publicly divulged even after sanctions have been issued. Thus it can be difficult even to determine the basis for a designation. However, some designees have had success getting their status changed in Europe, and US courts have recently issued limited but notable decisions that may open the door to successful challenges. Even successful challenges can take years to play out, but the cost of an asset freeze can be extraordinary, and many designees will consider mounting a challenge despite the difficulties.

The EU has jurisdiction in the following five situations:

1. within the EU territory
2. on board any aircraft or vessel under EU Member State jurisdiction
3. nationals of EU Member States (even if outside the EU)
4. entities incorporated or constituted under the law of a Member State
5. entities in respect of any business done in whole or in part within the EU

UN General Assembly at the United Nations headquarters in New York

© EMMANUEL DUNAND/AFP/GettyImages

Challenging designations

Both at the UN and national (or regional) level, asset freeze listings are determined through the use of secret information and without prior legal proceedings. In the EU, for example, the Member States adopt asset freezes in closed Council meetings, and the identity of listed parties is not publicly known until relevant Decisions and Regulations are published in the Official Journal just before entering into force. A separate notice will simply inform the prohibited party of available legal remedies (i.e., either request that the Council reconsiders the listing or challenge the sanctions before the General Court of the EU). While there may be important security concerns that warrant these secret and swift practices, fundamental due process rights can also weigh against such sweeping government authority. Challenges to these listings can therefore be important.

Lately, there has been a string of EU court decisions annulling EU asset freeze listings, chiefly because listing criteria were not met. For example, a June 2014 court decision annulled the listing of Syria International Islamic Bank for insufficient grounds, where the listing was based mainly on allegations that the bank had allowed other listed banks (state-owned Commercial Bank of Syria and its subsidiary Syrian Lebanese Commercial Bank) to circumvent EU sanctions by facilitating transactions for their (non-listed) account holders.[1]

A series of judgments arising from challenges to the EU listing of Mr Yassin Abdullah Kadi – listed by the UN Sanctions Committee based on his alleged association with Osama Bin Laden and the Al-Qaeda network – inform the value of the judicial review process. The judgments in Mr Kadi's case have been instrumental in shaping the EU sanctions framework by increasing the judicial scrutiny of Council decisions imposing asset freezes.

The Kadi judgments have not only confirmed the availability of judicial review of EU measures implementing UN Security Council

1. See Judgment in Case T-293/12, *Syria International Islamic Bank PJSC v. Council* (June 11, 2014).
2. See Judgment in Joined Cases C-584/10 P, C-593/10 P and C-595/10 P, *European Commission and Others v. Yassin Abdullah Kadi* (July 18, 2013).
3. *Kadi v. Geithner, — F. Supp. 2d —, 2012 WL 898778, at *19 (D.D.C. Mar. 19, 2012)*

asset freeze resolutions, but also that the listing grounds specified by the Council must be "individual, specific and concrete." In addition, the ECJ confirmed that the listed party's rights of defence will require the Council to disclose the evidence supporting the listing decision to allow the listed party to submit observations.[2] By sharp contrast, Mr Kadi was less successful in challenging his US designation.[3] In this case, Kadi's claims were dismissed and it was found that "substantial evidence" supported OFAC's continued designation of Kadi as a "Specially Designated Global Terrorist" (SDGT). Notably, Mr Kadi voluntarily dismissed his appeal of the lower court's rejection of his OFAC petition.

In the United States, administrative and judicial review is available to those who believe they have been erroneously placed on the "Specially Designated Nationals and Blocked Persons List" ("SDN List") in connection with US economic sanctions programs. The SDN List is maintained by the US Department of the Treasury's Office of Foreign Assets Control (OFAC)—the agency that administers and enforces US economic sanctions programs.

It is not settled whether an SDN must first petition OFAC to be delisted before seeking judicial review of the designation. Whether the SDN petitions and is denied, or goes directly to court, a US court will overturn OFAC's decision only if it was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law".[4] This is a high standard for an SDN to meet, particularly where the SDN's access to OFAC's supporting evidence may be restricted by national security or foreign policy concerns.

Judicial precedent concerning delisting petitions remains sparse, which is likely attributable to the fact that few aggrieved parties challenge OFAC or take their case to court. However, some limited but notable developments in challenging OFAC's designation process have occurred in recent years through judicial review. In 2011, for example, a US federal court of appeals held in *Al Haramain Islamic Found., Inc. v. US Dep't of Treasury*[5] that the due process rights of the blocked entity (a Specially Designated Global Terrorist, "SDGT") had been violated where OFAC had failed to mitigate the SDGT's inability to view the classified information underpinning the designation: "Without disclosure of classified information, the designated entity cannot possibly know how to respond to OFAC's concerns. Without knowledge of a charge, even simple factual errors may go uncorrected despite potentially easy, ready, and persuasive explanations."

Such mitigation was held to include providing an unclassified summary or giving access to classified material to the SDGT's lawyers possessing the requisite security clearance.

OFAC was faulted by the Court for waiting seven months before giving any reason for the designation and

"However, some limited but notable developments in challenging OFAC's designation process have occurred in recent years through judicial review

4. *Zevallos v. Obama*, CV 13-0390 (RC), 2014 WL 197864 (D.D.C. Jan. 17, 2014) (quoting 5 U.S.C. § 706(2)(A)).

5. *Al Haramain Islamic Found., Inc. v. U.S. Dep't of Treasury*, 686 F.3d 965, 983 (9th Cir. 2011).

US SANCTIONS PROGRAMS

US sanctions programs are country-based (e.g., the Iran, Syria and North Korea programs) or "list-based" (e.g., programs targeting those engaged in various activities such as terrorism, narcotics trafficking and efforts to undermine democratic processes such as the recent Ukraine-related sanctions). Designation as a blocked person on the SDN List means that your property and property interests must be frozen if they come within the United States or the possession, custody or control of a "US person" wherever located and US persons are prohibited from having any dealings with you or your property. Depending on the US sanctions program at issue, the phrase "US person" can include US citizens worldwide, green card holders, persons or entities within the United States, US incorporated entities, including their foreign branches and in more limited cases, their foreign subsidiaries.

providing only one document in four years that could be viewed as providing some reason for the designation. Similarly, in *KindHearts for Charitable Humanitarian Dev., Inc. v. Geithner*,[6] the court found OFAC had violated procedural due process by waiting 15 months to provide the SDN with a largely uninformative, unclassified record of the basis of the designation.

The court agreed that one of OFAC's bases for designating the charity was not supported by substantial evidence. In addition, the court found that OFAC had violated the SDGT's Fourth Amendment right to be free from unreasonable seizure by failing to obtain a warrant before issuing a blocking order freezing the SDGT's assets.

Although the court ultimately concluded that the due process violation was harmless and other reasons supported OFAC's continued designation, the case demonstrates that OFAC's discretion, while broad, is not unfettered. Courts in other circuits have shown a willingness to test OFAC's evidence *in camera*—but thus far there are no reported judicial decisions reversing an OFAC designation. By way of example, in *Zevallos v. Obama*,[7] OFAC's designation of an individual as a "Significant Foreign Narcotics Trafficker" was found to be supported by substantial evidence and that due process had been followed, despite finding OFAC's three years of "radio silence" to be "troubling". The decision is currently pending before the D.C. Circuit Court of Appeals. This general silence is largely attributable to the fact that few designated persons file judicial challenges, as noted in *Al Haramain Islamic Found., v. U.S. Dep't of Treasury*. Instead designated persons, particularly those designated under secondary, extraterritorial sanctions, have experienced greater success in brokering a negotiated solution with OFAC—for example, by agreeing to implement new compliance procedures and systems and alter their activities in exchange for delisting. For example, Elaf Islamic Bank, a private Iraqi financial institution listed on the "Part 561 list," was successfully delisted by OFAC in May 2013 reportedly upon change in behavior.[8]

Lessons learned

As shown by the US and EU examples given above, certain challenges to asset freeze listings have been vital in increasing judicial scrutiny of the relevant government authorities, or decision making process, and more generally in structuring the developing sanctions frameworks. While the sanctions tool is a powerful means of exerting political pressure, crucially, it must afford due process to those it affects directly. ■

While the sanctions tool is a powerful means of exerting political pressure, crucially, it must afford due process to those it affects directly

Reading the signals

Steps to comply with sanctions and limit exposure

- Screen parties to transactions (e.g., customers, suppliers, distributors, transportation companies, banks) against comprehensive designated party lists
- Perform due diligence with respect to ownership of parties to transactions, including beneficial ownership
- Perform heightened due diligence with respect to transactions where there are red flags or otherwise may be a reason to believe a designated entity is benefiting from a transaction that on its face does not involve one
- Consider additional contractual language and other protections in contracts and transaction documents to cover current or future sanctions
- Review and ensure that compliance programs are robust and effective, with adequate procedures and training programs, and are updated to account for evolving sanctions
- Monitor and anticipate possible future sanctions
- Seek OFAC or other authorization, wherever necessary

6. *KindHearts for Charitable Humanitarian Dev., Inc. v. Geithner*, 647 F. Supp. 2d 857, 906-08 (N.D. Ohio 2009).

7. *Zevallos v. Obama*, CV 13-0390 (RC), 2014 WL 197864, at **9, 14-16 (D.D.C. Jan. 17, 2014).

8. OFAC announcement, July 31, 2012, available at http://treasury.gov/resource-center/sanctions/OFAC-enforcement/pages/20120731.aspx.

Sanctions and export controls can hit hard and fast

International crises, most recently in Ukraine, Syria and Iran, have resulted in largely US-led sanctions imposed against "offending" states—requiring businesses to comply with trade embargoes or face penalties

Tom Blass

Editor, *WorldECR*

With Ukraine in turmoil, the United States government and the European Union announced the designation of a number of Ukrainian individuals, in response to the tumultuous events unfolding. By the middle of March, Russia's duma had "welcomed" the Crimea into its fold, in effect annexing the largely Russian-speaking peninsula. Again, the West responded rapidly, targeting more individuals and, in the case of US sanctions, the businesses they own or control.

Though limited and uncertain in extent, the development was a picture-perfect illustration of how, while other legislation can take years or decades to draw up, sanctions tend to be imposed with abrupt rapidity.

Sanctions and economic embargoes have been used as a tool of foreign policy for millennia, though never before has it been as complex and multilayered as today, with companies and financial institutions needing to implement compliance programs that accommodate tiers of sanctions, not only those imposed by the United Nations, but also at the regional level, the EU, for example, and the unilateral sanctions regimes of individual states.

But it is the fear of falling foul of the agencies responsible for enforcing the US Iran and Syria sanctions legislation that has put the issue close to the top of the compliance agenda for many businesses.

In the last two years, US agencies, including the Office of Foreign Assets Control, the Department of Justice and the Securities Exchange Commission, have imposed swingeing fines and settlement agreements on US and non-US banks and corporations for alleged sanctions and export control violations.

> **"It is not only the severity of the potential fines, but also the reputational impact of these actions that have convinced business to take sanctions seriously**

It is not only the severity of the potential fines, but also the reputational impact of these actions that have convinced business to take sanctions seriously, and to put in place sophisticated internal compliance procedures, training programs and screening mechanisms to ensure they're not conducting business with sanctioned parties.

Investigations typically arise through one of two scenarios; either agencies intervene or a business commissions an investigation into its own activities having got wind of a potential violation or violations, with the intention of making voluntary self-disclosure to the authorities. But agencies can also order that a business undertake such an investigation as part of its undertakings on making a settlement.

Commissioning or submitting to a sanctions investigation is not for the faint-hearted. If it is to be effective and convincing, it requires the utmost candidness. It is time-consuming and often expensive.

Given the ever-widening scope both of international business and sanctions, which as recent events have proven can hit hard and fast, it is likely that an increasing number of businesses will either consider commissioning investigations into their own activities—or be left with little choice but to do so. ■

High-frequency trading: under the watchful eye of global authorities

High-frequency trading has come under intense scrutiny in recent months. White & Case explores this latest global investigations trend

High-frequency trading (HFT), which relies on high speed data transmission technology and computer algorithms to trade securities in fractions of a second, has come under intense scrutiny following the publication earlier this year of *Flash Boys: A Wall Street Revolt*, by Michael Lewis. In *Flash Boys*, Lewis contends that high-frequency traders, along with complicit brokers and stock exchanges, have essentially "rigged" the equities markets by using superior technology to beat non-HFT investors' orders to market. Federal government regulators and the plaintiffs' bar, seizing upon Lewis's allegations, have initiated investigations of and lawsuits against high-frequency traders, financial institutions, exchanges and alternate trading venues, known as "dark pools."

This increased regulatory and legal scrutiny has put a spotlight on previously unknown and little-understood trading practices, and demonstrates how technological advancement often outstrips investigatory and regulatory priorities and resources.

Shining a light on dark pools

Since its emergence roughly a decade ago, HFT has been largely unregulated and dominated by a few specialized and unknown proprietary trading shops. At its peak in 2009, it was estimated that HFT accounted for about 60 percent of average daily trading on US stock exchanges, bringing in an overall profit of almost US$5 billion. Although profits have declined in recent years, HFT still accounts for a significant percentage of average daily trading in US markets. ("Declining US High-frequency Trading", *New York Times*, October 15, 2012.) In the wake of the increased media and public attention triggered by Lewis's incendiary assertions regarding HFT, US regulators (and, indeed, other regulatory bodies around the world) have stepped up their scrutiny of such trading practices in an effort to allay concerns that HFT exploits ordinary investors and increases market instability. This increased regulatory focus has resulted in proposals by the SEC (and other regulators, notably in Europe) that would require high-frequency traders to, among other actions, register with regulators as broker dealers, thereby subjecting themselves to the compliance requirements and controls of these regulatory agencies.

Regulators have also now trained their sights on so-called "dark pools"—unregulated, private exchanges, often owned and operated by large investment banks, where an estimated 40 percent of US equities are now traded and which have facilitated the growth of HFT. ("SEC Chairman Targets Dark Pools, High-Speed Trading", *Wall Street Journal*, June 6, 2014.)

As part of its call for greater transparency in the operation of dark pools, the SEC has criticized (and, in at least one instance, sanctioned) registered exchanges for practices such as "co-location"—that is, allowing HFT firms to site their computer servers alongside exchange servers to obtain a greater speed

> **Increased regulatory and legal scrutiny has put a spotlight on previously unknown and little-understood trading practices**
>
> Paul Carberry, Partner, White & Case, New York

advantage. Other activities now on the US government's radar include allowing the use of complex order types favored by high-frequency traders and orchestrating "payment for order flow" programs that incentivize brokers to divert customer trades to exchanges where high-frequency traders operate. Similarly, brokerages have been openly criticized for routing customer trades into exchanges offering the highest trading rebates, perhaps at the expense of the customer's right to "best execution" of their trade.

In addition to the SEC, in the US other regulatory bodies including the CFTC, FINRA, Department of Justice, the FBI and the New York State Attorney General's office, have each announced investigations into high-frequency traders and other industry participants, accusing them of profiting unfairly at the expense of ordinary investors through their use of sophisticated technology, speed advantage and utilization of complex order types.

The New York State Attorney General has been the most active so far, issuing subpoenas and letters of inquiry to exchanges and dark pool operators seeking information concerning how these trading venues have facilitated HFT. In addition, the Attorney General's Office recently filed a complaint against a major European bank, alleging that it lied to investors by claiming its dark pool was safe from "predatory" high-frequency traders when, in fact, it had deliberately courted such traders to its exchange, concealing their presence from customers. As these investigations proceed, it becomes increasingly likely that additional exchanges, financial institutions and trading outfits will find themselves the subject of regulatory inquiry, if not legal enforcement action.

A global phenomenon

European regulators have likewise taken an interest in these activities. Stuart Willey, a partner in the Capital Markets group of White & Case and head of its regulatory practice in London, notes: "European regulators now have high-frequency trading firmly in their sights, and major changes in this area are being implemented across Europe as regulators struggle to keep pace with technological advancement."

> **As these investigations proceed, it becomes increasingly likely that additional exchanges, financial institutions and trading outfits will find themselves the subject of regulatory inquiry, if not legal enforcement action**
>
> Stuart Willey, Partner, White & Case, London

The European Commission has published legislative proposals, known as "MiFID II", which introduce closer regulation and monitoring of HFT. MiFID II will impose detailed requirements on trading venues and the firms that trade on them. HFT firms engaging in proprietary trading will need to be authorized, and the rules will impose liquidity provision requirements on market making agreements between firms and venues. Trading venues will be required to set limits on the maximum number of order messages that a market participant can send relative to the number of transactions they undertake, and venues will be able to create fee structures for excessive order cancellation and systems use. Any firm deploying a trading algorithm will in the future be required to notify its regulator and relevant

trading venues and may be required to produce descriptions of its trading strategies and to provide assurance as to the controls the firm has instituted to ensure its algorithmic trading cannot spin out of control. The proportion of equity trading that can occur in dark pools without pre-trade transparency will also be limited by new (complex) EU-wide legislation.

While MiFID II remains a work in progress, there are differing views across Europe as to the appropriate regulatory approach. Germany has already implemented regulations covering HFT such that investment firms and other market players carrying out high-frequency algorithmic trading on the German market are now subject to supervision and must submit documentation to BaFin, the German regulator, in order to obtain authorization to conduct such trades. Authorities in Italy have introduced a tax on high-frequency equity and derivative trades. On the other hand, in the UK the Financial Conduct Authority (FCA), the UK regulator, has adopted what it describes as a risk-based approach. In a recent speech at the Global Exchange and Brokerage Conference, Martin Wheatley, CEO of the FCA, said that the FCA was adopting a three-pronged approach, namely, analysis-led policy work to get rules in shape with the bulk of the work being absorbed in gearing the UK up for MiFID II implementation; day-to-day supervision of relevant firms and markets applying a risk-based approach; and active market surveillance.

Nothing to see here

Despite increased scrutiny and the accusations leveled against HFT, some maintain that all is well within US markets. For instance, Mary Jo White, chairwoman of the SEC, recently insisted to Congress that "the markets are not rigged" and "the retail investor is…very well served by the current market structure." These sentiments echo the assertions of defenders of HFT who claim that their practices increase market liquidity, improve price-discovery, i.e., the ability to trade stocks at fair value, and decrease trading costs due to the narrowing of buy-sell spreads. This is consistent with the SEC's focus on enacting further reforms aimed at ensuring greater transparency and accountability in the market rather than eliminating HFT entirely.

The future

In addition to increased regulatory scrutiny, at least in the US, the private class action plaintiffs' bar has also zeroed in on HFT by filing a number of lawsuits in federal court on behalf of investors alleging the actions of high-frequency trading firms, brokers and exchanges violated US securities laws. While the legal theories underlying these class action lawsuits appear somewhat suspect—for instance, it is not clear how a high-frequency trader's use of faster trading technology to beat another investor's order to market violates US law—we anticipate that such theories will evolve and develop as regulators uncover (and publicize) additional information concerning how HFT firms and dark pools operate.

"I have little doubt that the plaintiffs' bar is intently focused on the various regulatory investigations currently under way in the US and elsewhere with the objective of further developing their understanding of these trading practices so they can craft the next wave of claims against various market participants. The complaint recently filed against a dark pool operator, by one of its customers piggybacking off of the charges asserted by the New York Attorney General against the same bank, only goes to show that this is a strategy likely to be pursued by other plaintiffs' lawyers in the future," said US securities litigator and White & Case partner Greg Little.

Despite the specter of heightened regulation, further legal enforcement action and private lawsuits, HFT is likely to remain a significant feature of equities markets globally with ever-increasing influence in equity markets across Europe, Asia and Latin America. Over time, HFT is also likely to infiltrate further into non-equities markets as well. Ongoing advances in computer and data transmission technologies, such as transmitting orders by microwave, continue to promise traders the ability to profit from trades executed on the basis of increasingly small increments of a second. It is, therefore, inevitable that governmental regulators, as well as those in the media and the public at large, will demand exacting oversight and scrutiny of the new technologies and the trading practices spawned by them. ■

Reading the signals

HFT—future regulatory scrutiny

- Monitor activity of the US private class action plaintiff's bar
- Follow EU-wide MIFID II developments
- Be aware of differing regulatory regimes across Europe
- Be alert to the infiltration of HFT practices into non-equities markets

"The Plaintiff's bar is intently focused on the various regulatory investigations currently under way so they can craft the next wave of claims against various market participants

Greg Little, Partner, White & Case, New York

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