BUDDLE FINDLAY

Legal update on regulatory and investigations - June 2016

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Costs awarded against SFO in South Canterbury Finance case

The High Court's criticisms of the Serious Fraud Office (SFO) in its judgment last year finding former South Canterbury Finance chief executive, Lachie McLeod, not guilty on all charges was probably quite enough for the SFO. However, the costs judgment released in February went a step further.

Costs may only be obtained against a prosecutor in a criminal case in circumstances where the court considers it to be just and reasonable. Factors the court will have regards to is, where the prosecution acted in good faith, whether there was sufficient evidence at the commencement of the proceeding and whether the investigation into the offence was conducted in a reasonable and proper manner.

While McLeod had sought a significantly higher sum for costs in relation to five charges which he says "*should never have been laid*", the court awarded costs in respect of two charges only. The first, Count 8, alleged theft in a special relationship arising out of a transaction with Dairy Holdings Limited. This related to a loan given to the director of Dairy Holdings Ltd, Mr Armer. Justice Heath said that the dismissal of those charges resembles "*a conclusion of innocence*".

The second, Count 10, alleged that the defendants provided false information to the Crown to obtain a favourable decision to allow South Canterbury Finance to enter the Guarantee Scheme. Heath J found that the Secretary (Dr Whitehead) would have accepted South Canterbury Finance's entry into the Guarantee Scheme regardless.

In his judgment, Justice Heath criticised the SFO describing the standard of investigation as 'poor':

- The SFO did not obtain documents (either voluntarily or under compulsion) from the Treasury and the Reserve Bank of New Zealand to ascertain what steps had been taken to analyse information based on what the Crown contended were material misrepresentations
- The key decision-maker, Dr Whitehead, the Secretary of the Treasury, was never interviewed. Nor were any steps taken to interview someone with the knowledge of the internal decision-making of the Treasury
- There was no attempt "*to ascertain whether the prospect of contagion as a result of offshore financial collapses, or the political reality of the time, would have led to the guarantee deed being signed, irrespective of any misrepresentation*."
- As CEO Mr McLeod had no responsibility for confirming the accuracy of the prospectus. The directors bore that responsibility
- Mr McLeod was interviewed once and he was not questioned about the Guarantee Scheme and no documents relating to it were put to him for comment.

Justice Heath commented that "*in the context of what the Director announced publicly to be the 'biggest fraud in New Zealand's history' and one that was 'the most resource intensive and time consuming in recent history', the standard of investigation on this charge fell well below that which the public is entitled to expect"*. Justice Heath said that Dr Whitehead could have told the Crown he would sign the guarantee deed regardless. A statement to that effect would have "*inevitably*" led to the charge not being laid. The Court considered that the failure to obtain evidence directly from Dr Whitehead was a "*fundamental error*" on the part of the investigation team.

Justice Heath finished by noting that while he "*levelled stern criticism at the standard of investigation on Count 10*" he did not want an award of costs to be of such a sum that it would provide a disincentive for the Crown to prosecute appropriate cases in the future. He also noted that while some of the behaviour of the accused was not proven to be criminal, it fell well below the standards expected of those responsible for the stewardship of funds provided by members of the public, and indeed some behaviour was commercially unacceptable.

Criminal offence for cartels thrown out of Commerce (Cartels and Other Matters)

Amendment Bill

The government has agreed to remove the criminal sanctions for cartel behaviour from the Commerce (Cartels and Other Matters) Amendment Bill (Bill), which is currently winding its way through Parliament.

The criminalisation of cartels had drawn a high degree of scrutiny from the business community, as some feared it would be too easy to fall afoul of the provisions and its imposition could have a chilling effect on legitimate pro-competitive business activities. The criminal sanctions under the Bill, included a sanction of imprisonment for up to seven years.

The original objective for its inclusion had been to promote detection and deterrence of cartel conduct and to ensure that New Zealand's competition regime was not out of step with overseas jurisdictions that have increasingly imposed criminal sanctions for cartel conduct (criminal sanctions exist in both Australia and the United Kingdom).

However, the Minister of Commerce and Consumer Affairs Paul Goldsmith announced that the inclusion of the criminal sanctions had been re-examined and "*on balance*" should be removed. The following arguments were considered in reaching this decision:

Arguments for criminalisation

- *Improved detection*: threat of imprisonment would provide an incentive to seek leniency and cooperate with the Commerce Commission (Commission)
- *Improved deterrence:* threat of imprisonment and social condemnation of criminal conduct
- *Improved international cooperation:* mirrors approach taken by other countries
- *Single economic market:* advances a Single Economic Market with Australia by ensuring firms are faced with the same consequences for anti-competitive conduct (in Australia and in New Zealand).

Arguments against criminalisation

- *Chilling effect on pro-competitive activity:* may deter legitimate and pro-competitive business activities
- *Increased compliance costs:* to minimise risk of criminal liability companies and employees may seek more legal and expert advice
- *Poorly distinguishes between the criminal offence and civil prohibition:* the Bill distinguished criminal cartels from civil cartels based on the 'intent' of the individual engaging in cartel conduct and not the cartel's impact. There is concern that intention alone may not convey sufficient blameworthiness, which creates some uncertainty as to what level of cartel harm would be required for a criminal proceeding and conviction
- *Administration and enforcement costs:* the Commission would incur costs implementing the criminal regime, investigations would need to be investigated to a criminal standard, and criminal prosecutions may take longer than civil proceedings. Also, corrections would incur additional costs for imprisoning convicted individuals.

You can read about our previous coverage of the Bill here.

Vivier appeal - Financial service provider with no services in New Zealand? Alarm bells should sound!

In *Financial Markets Authority v Vivier and Company Limited* [2016] NZCA 197, the Court of Appeal has clarified the circumstances in which a financial services provider (FSP) might be deregistered on the basis that its registration is misleading. In doing so, it reconciled the difference between two contrasting High Court authorities - that of Brewer J in the case under appeal, and that of Nation J in a second case, *Excelsior Markets Limited v Financial Markets Authority* [2015] NZHC 3334.

In *Vivier* the respondent was a New Zealand company registered as a FSP under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. In February 2015 the Financial Markets Authority (FMA) became concerned that Vivier was not providing any financial services in or from New Zealand. The FMA formed the view that the fact of Vivier's registration in New Zealand might be misleading to customers or damage the reputation of New Zealand's financial markets. Accordingly, the FMA directed that Vivier be deregistered. It was that direction which was challenged by way of appeal in the High Court and further appeal by the FMA in the Court of Appeal.

Brewer J had held that that direction to deregister was invalid for the following reasons:

- The statutory framework required the FMA to have evidence relating to the particular FSP in terms of whether its registration was misleading or harmful to New Zealand's market reputation
- The FMA had failed to observe the principles of natural justice, in that it had not disclosed to Vivier the anonymous complaint

nor a news article that was said to be the basis for the complaint

- The FMA had acted unfairly in failing to provide Vivier with the further information requested in its submissions.

In a related decision, Nation J differed on a number of points to Brewer J. Relevantly, those included:

- That the FMA did not need further evidence specific to the particular FSP to justify a direction requiring deregistration – it could rely simply on the fact that a FSP was providing services almost wholly outside New Zealand
- Relatedly, the FMA was a specialist body with knowledge as to how financial markets operated, which meant that its decisions (provided they were reasonable) were likely to be respected.

The Court of Appeal, by and large, agreed with Nation J and overturned the decision under appeal. In particular, the important points for FSPs are that:

- The FMA is entitled to look as to whether or not the FSP is providing financial services in or from New Zealand, and whether it is generating any associated financial activity in New Zealand – if it were not doing or intending to do so then "*alarm bells should sound*"
- It would still be open to bona fide FSPs with a place of business in New Zealand, but no relevant financial service activity in New Zealand to seek registration if they could show good reasons for their registration
- The FMA, as a specialist body, was entitled to draw appropriate inferences based on its own expert knowledge and experience in making its decisions.

The decision paves the way for the FMA to seek deregistration of any FSPs whom have a place of business in New Zealand, but which do not offer financial services within New Zealand – unless such FSPs can demonstrate that they are nonetheless a substantial and reliable FSP with proper interests in New Zealand.

Lord Neuberger (UKSC) speaks on privilege and its place with corporate internal investigations

President of the UK Supreme Court, Lord Neuberger delivered a speech this month regarding the challenges arising for companies and lawyers when claiming legal professional privilege over internal investigations. The issue of whether such investigations will attract privilege is a complex one. The lawyer advising his/her client can rarely give a 'safe' answer: *"Go wrong one way, and she will be advising her client to break the law; go wrong the other way and she will be unnecessarily disadvantaging her client.*"

The scenario of a company carrying out its own internal investigation into a matter and then a regulatory body requesting the resulting documents is not uncommon. If litigation privilege can be claimed, then the issue is not so difficult. However, legal proceedings must be in contemplation and the investigation must be for the dominant purpose of preparing for that proceeding in order to claim litigation privilege.

If the company is relying on legal advice privilege, one issue is whether the scope is so broad that it extends beyond individuals that can constitute 'the client'. Legal advice privilege applies only to communications passing between the client and their solicitor. It does not apply to documents passed between a client and its solicitor for advice to be given in respect of them. It also does not apply to communications between the solicitor and employees or agents of the corporate client other than the individuals actually instructed by lawyers (for example the Board, CEO, CFO or other executives). Issues can arise if, for example, witness statements were taken from employees and third parties who are not 'the client'.

Lord Neuberger explains that when a company is carrying out an internal investigation, it is sensible to decide from the start which group of individuals constitute the client. If a court considered the group was artificially large, then "*the greater the risk of loss of confidentiality*" may well result in a finding that not all members of the group are the client and privilege may be lost.

Lord Neuberger also referred to corporate internal investigations into bribery and similar crimes. The policy of the UK Serious Fraud Office (SFO) is that prosecution might be avoided if the company concerned had shown a "*genuinely proactive approach*" of self-reporting. The SFO said that "*in considering whether a self-reporting corporate body has been genuinely proactive, prosecutors will consider whether it has provided sufficient information, including … disclosing the details of any internal investigation, about the operation of the corporate body in its entirety*".

Lord Neuberger rightly expresses his concern that legal professional privilege is "*a very valuable right*" and to waive it is "*a big and irrevocable step*". As a result, this "*puts any legal adviser of a company framing her advice to the company as to whether to self-report in something of a quandary.*" Ultimately, however, the choice may not be that of the company. The SFO has had both wins and losses in having internal investigation documents handed over to it. The take-home message from Lord Neuberger to legal advisers was clear: tread carefully.

FIFA scandal: The sport of White Collar Corruption

FIFA, the Fédération Internationale de Football Association, is the organisation that governs football, the most popular game in the world. The World Cup is the most watched sporting event in the world. Bigger than the Olympics, it produces billions of dollars in revenue from corporate sponsors, merchandising and broadcasting rights. Recently, however, FIFA has been plagued with allegations of corruption and law enforcement agencies have accused FIFA's top executives of being involved in large-scale corruption, benefiting personally from bribes and kickbacks.

Eyebrows were first raised in December 2010, by the bidding process that saw Russia awarded the 2018 World Cup and Qatar given the 2022 hosting rights. Both results were surprising. Russia has a long history of racism in football and was in hot water over its involvement in the Ukrainian crisis. The Qatar win was even more unexpected. While it is a rich country, it has limited football history and chequered human rights history. In addition, the World Cup is traditionally played during the European summer, the off-seasons of European football. This means the tournament in Qatar would be played in temperatures potentially exceeding 50°C. Finally, in contrast to its other bidders, United States, South Korea, Japan and Australia, Qatar has little or no existing footballing infrastructure (of the size and scale required of a host nation).

Questions of vote-buying were on many peoples' lips. As a result, in July 2012, FIFA commissioned US Attorney, Michael Garcia, to give an independent report into the bidding process and decision behind the 2018 and 2022 hosting rights.

Garcia released his 350 page report in September 2014. However, FIFA chose not to release it, instead releasing, in November 2014, a 42 page summary which it said cleared Russia and Qatar of any wrongdoing during the bidding for the 2018 and 2022 World Cups. However, the Associated Press described the summary as "*a whitewash*". Garcia resigned in protest claiming that the summary was *"materially incomplete*" with "*erroneous representations of the facts and conclusions*". Both Switzerland and the United States commenced criminal investigations into allegations of fraud, money laundering, bribery and racketeering within FIFA.

But the drama really kicked off in late May 2015. FIFA executive members had gathered in Zurich, Switzerland, staying at the Baur au Lac hotel, for two days of official FIFA meetings. In the early hours of 27 May 2015, Swiss police (at the behest of the US Justice Department) raided the luxury hotel and arrested seven FIFA officials on suspicion of receiving bribes and kickbacks.

US criminal charges

The seven FIFA officials were formally indicted on various charges and extradited to the US. On 3 December 2015, a further 16 officials were added. Now, a total of 23 FIFA officials face 92 counts under the United States criminal code, including racketeering conspiracy, fraud, wire fraud, money laundering and obstructing justice. The charges have been brought under the Racketeer Influenced and Corrupt Organisations (RICO) Act, which was intended for use against the Mafia. Bribery charges could not be laid as, under US law, bribery is restricted to payments to government officials.

The money involved is eye-watering. The Justice Department claims that the criminal schemes involve well over US$200m (NZ$287m) in bribes and kickbacks. More specifically, the indictments allege:

- The criminal schemes spanned 24 years
- Media and marketing rights were fraudulently awarded to large corporate entities for FIFA events across the Americas
- Bribes were taken to influence FIFA sponsorship contracts, the selection process of the 2010 World Cup and the 2011 FIFA presidential election
- Large sports goods manufacturers paid FIFA significant sums of money for exclusive rights to provide clothing and equipment for FIFA football events. These companies have sought to distance themselves from FIFA's corruption, claiming they knew nothing of where their money was going, or to whom.

Charles "Chuck" Blazer, former general secretary of the Confederation of North, Central America and Caribbean Association Football (Concacaf), who is cooperating with US prosecutors, has further said that between 2004 and 2011:

- He and others on the FIFA executive committee accepted bribes for the selection of South Africa as the host of the 2010 World Cup
- A colleague received a bribe from Morocco for its bid to host the 1998 tournament, which was eventually awarded to France
- He and others also accepted bribes relating to broadcast and other rights to the Concacaf Gold Cup tournament in 1996, 1998, 2000, 2002 and 2003.

An email obtained by the media appears to show that the then South African President, Thabo Mbeki, and FIFA President, Sepp Blatter agreed to a US$10m deal that US prosecutors say was a bribe to secure the 2010 World Cup for South Africa. The South African government insists it was a legitimate payment to promote Caribbean football.

Thus far, eight defendants have made guilty pleas and have agreed to forfeit US$40m. However, the majority have maintained their not guilty position and will face trial.

In respect of jurisdictional issues, the Department of Justice's claims that the corruption was planned in the US, even if it was then carried out elsewhere and in addition, US banks were used to transfer money appear to be key to the investigation.

Swiss criminal investigation

Concurrently, Swiss prosecuting authorities are also undertaking criminal investigations into the bidding process in respect of the 2018 and 2022 World Cup hosting rights.

It was only a matter of time before the spotlight was turned on Sepp Blatter. On 25 September 2015, the Swiss prosecutors commenced criminal proceedings against Blatter for criminal mismanagement or misappropriation over a TV rights deal and a "*disloyal payment*" to European football chief Michel Platini of $2m Swiss francs (NZ$2.98m on current exchange rates).

Blatter refused to resign. On 8 October 2015, Blatter, Platini and Secretary General Jerome Valcke were suspended for 90 days by FIFA's Ethics Committee. Blatter appealed the suspension but lost the appeal on 18 November 2015.

FIFA has denied that Russia and Qatar paid bribes in return for votes. Sepp Blatter too has protested his innocence, stating that a World Cup cannot be bought. However, when asked whether his executives were receiving bribes and kickbacks, his response was that he could not watch every one of his executives all the time.

Meanwhile, FIFA executives are dropping like flies. On 3 December 2015, FIFA vice-presidents Alfredo Hawit and Juan Angel Napout were arrested on suspicion of bribery in the same Zurich hotel where the FIFA officials had been arrested in May.

Banks – implications of the scandal

The FIFA scandal has also questioned the conduct of banking institutions. Law enforcement authorities have levelled serious questions at the role the banks may have played in this scandal and whether they should have raised more objections to the transfer of money obtained fraudulently.

US Department of Justice has claimed that the accused relied on the use of *"trusted intermediaries, bankers, financial advisers and currency dealers, to make and facilitate the making of illicit payments*". In particular, US prosecutors are investigating Citigroup over its ties to the alleged bribery and corruption at FIFA. Other banks such as JPMorgan Chase, HSBC, UBS, Bank of America, Espirito Santo Bank and Julius Baer have all been named as banks through which 'FIFA funds' are said to have passed.

While on the one hand many of the banks named in the indictments have cooperated and assisted law enforcement agencies in identifying the FIFA officials involved, questions remain as to whether banking practices and procedures were sufficient as to identify and prevent such fraudulent activity. At least three banks, HSBC, Standard Chartered and Barclays have already announced internal probes into the payments.

Nonetheless this sends a warning shot to banks to ensure they have appropriate processes and procedures to identify and prevent fraud and money laundering.

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