Linklaters

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Regulatory Investigations Update.

While the FSA continues to demonstrate its determination to prosecute market abuse, its future remains uncertain. No further details on the proposed serious economic crime agency have been made available, despite the government's indication in June that a comprehensive consultation document would be published before Parliament's Summer recess. Developments in other European jurisdictions have strengthened domestic regulators' powers to investigate, prosecute and take steps to prevent insider dealing and money laundering. Meanwhile, in Brussels the EU Commissioner for Internal Market and Services has emphasised the need for a consistent strategy for market regulation and sanctions across all member states.

To keep you up-to-date with regulatory developments, Linklaters is launching a new Regulatory Investigations & Enforcement microsite – details below.

Contents

UK: News

Fighting financial crime in the new regulatory world: 9 November 2010

Margaret Cole, Director of Enforcement and Financial Crime at the FSA, has confirmed the FSA's intention to pursue its aim of preventing financial crime, prosecuting market abuse and insider dealing, and undertaking thematic reviews of the steps taken by banks and building societies to detect and prevent money laundering and other financial abuse. She noted that it is likely that most of the FSA's current work in enforcement and tackling financial crime will eventually be undertaken by the new Consumer Protection and Markets Agency (CPMA), adding that details of the scope and coverage of the proposed Economic Crime Agency were still awaited. However, she stressed the FSA's belief in the need to maintain specialist prosecutors with powers to bring criminal proceedings, to ensure a strong and effective enforcement function within the CPMA.

For the text of the speech, click here.

Searches and arrests for insider dealing: 2 November 2010

The FSA, acting jointly with the City of London Police Economic Crime Directorate, have executed search warrants at two addresses, one in London and one in Germany, and arrested two people on suspicion of insider dealing. The arrests follow an investigation by the FSA working with the police and prosecution authority in Hessen, Germany to co-ordinate and carry out the execution of the warrants.

The FSA is currently prosecuting 11 other individuals in unrelated matters for insider dealing.

For the FSA press release, click here.

Five charged in energy sector corruption ring: 22 September 2010

Five men have been charged with offences of conspiracy to corrupt following a two-year investigation by the SFO and City of London Police into allegations of corruption in relation to multi-million pound engineering contracts in the energy sector. It is alleged that confidential information was offered by the defendants to companies bidding for five contracts in high-value engineering projects in return for a percentage of the contract value. The prosecution has been brought following an investigation by the Serious Fraud Office in conjunction with the City of London Police. A plea and case management hearing is scheduled for 23 November 2010 at Southwark Crown Court.

For the SFO press notice, click here.

International investigation leads to five arrests: 15 October 2010

Following a joint investigation between the Serious Fraud Office and The Australian Federal Police involving the activities of the employees and agents of Securency International PTY Ltd, five arrests have been made in connection with the allegedly corrupt securing of international polymer banknote contracts. Search warrants had been executed in Britain, Spain and Australia.

For the SFO press release, click here.

SFO drops enquiry into sports cartel: 19 October 2010

The Serious Fraud Office investigation into Sports Direct International plc and JJB Sports plc has been completed. No charges are to be brought against the companies although the OFT investigation into alleged anti-competitive conduct in the sports goods retail sector is ongoing and the investigation into individuals continues.

The SFO investigation into suspected offences under the Fraud Act and the Enterprise Act commenced in September 2009. It arose from a referral by the Office of Fair Trading (OFT).

For the SFO press release, click here.

UK: Cases

FSMT increases FSA penalty for market abuse: 20 October 2010

Andre Jean Scerri, a private investor in Amerisur Resources Plc, used information that a placing was to take place to sell an existing share holding and subsequently rebuild his position by subscribing for discounted shares in the placing. The FSA had originally decided not to impose a disgorgement penalty of £20,000 on Scerri on the grounds that it would cause serious financial hardship. However, it later transpired that the information Scerri had provided to the FSA in connection with his financial hardship claim was incomplete and misleading. The Tribunal considered that Scerri's market abuse was serious and they decided to impose an additional financial penalty irrespective of his current financial position, increasing the penalty of £46,062.50 originally imposed by the FSA by a further £20,000.

The tribunal's decision is a clear indication that the plea of financial hardship will not be upheld where it becomes apparent that a defendant's financial situation arose as a result of self-induced diminution in financial net worth after he became aware of the proposed penalty.

For the FSA press release, click here.

Ex-insurance chief jailed for bribery: 19 October 2010

The former head of London-based insurance business PWS International Ltd, Julian Messent, has been jailed for 21 months and ordered to pay £100,000 to the Costa Rican government after admitting bribing Costa Rican officials from 1999 to 2002 in order to secure contracts for PWS. His conviction followed a joint investigation by the Serious Fraud Office and the City of London Police which commenced in 2006. Mr Messent authorised almost $2 million to be paid to top officials in "positions of power and influence" at Costa Rica's state insurance and electricity companies, in return for contracts awarded to PWS. He earned up to £428,000 in bonuses from the corrupt contracts.

Mr Messent may have been disappointed to receive a custodial sentence despite pleading guilty following the suspended sentence handed down to Robert Dougall, the former vice-president of DePuy International, a healthcare products company and subsidiary of Johnson & Johnson, earlier this year (and reported in our July Regulatory Investigations Update). Mr Dougall had pleaded guilty to conspiracy in relation DePuy's bribing of Greek healthcare officials in order to secure contracts for the company. His custodial

sentence was suspended on appeal following representations by the SFO that they had promised leniency in return for Mr Dougall's cooperation. However, the Court of Appeal made it clear in that case that prosecutors did not have the power to reach agreements with defendants on sentencing.

These cases highlight the tension between the judiciary keen to punish offenders, and prosecutors who want to encourage co-operation from suspects. The latter have raised concerns that harsh penalties may deter would-be whistleblowers from coming forward, although they acknowledge that the UK should not be seen to be soft on wrong-doers.

For the SFO press release, click here.

UK: Policy and Practice

FSA issues consultation on Article 2 MAD (CP 10/22): October 2010

The FSA is consulting on whether to delete MAR 1.3.4E of the Code of Market Conduct ("MAR") following the European Court of Justice's ("ECJ") decision on 23 December 2009 in the *Spector* case (Case C-45/08, *Spector Photo Group NV, Chris Van Raemdonck v Commissie voor het Bank, Financie- en Assurantiewezen (CBFA)*). MAR 1.3.4E sets out the FSA's opinion that, in a prosecution for insider dealing, it is necessary to provide evidence that the inside information was the reason for, or a material influence on, the decision to deal when deciding whether a person's behaviour is 'on the basis of' inside information, i.e. it is necessary to show an element of intention.

In the *Spector* case the ECJ had to interpret Article 2 of the Market Abuse Directive (MAD) which prohibits insider dealing and underpins the UK's legislation on this issue. The ECJ held that the fact that a person who holds inside information trades in financial instruments to which that information relates, implies that the person has 'used that information', although that is without prejudice to the person's rights of defence and, in particular, the right to rebut that presumption.

The UK implemented Article 2 in section 118(2) of the Financial Services and Markets Act 2000. While the FSA considers that that section remains consistent with the ECJ's decision in *Spector*, it now suggests that MAR 1.3.4E should be deleted since there no longer appears to be the need to provide any evidence of intent in order to imply use. The FSA has therefore included in its Quarterly Consultation for October 2010 a proposal to this effect, requesting comments by 6 December 2010.

This decision and consequent proposal would appear to make it easier for the FSA to bring successful prosecutions for insider dealing offences. The FSA comments in CP10/22 that the change is in line with its desire to promote the international character of financial markets and the desirability of maintaining the competitive position of the UK.

For the Consultation Paper, click here, section 6.

FSA power to provide consumer redress activated: 12 October 2010

The power for the FSA to establish consumer redress schemes for consumers, introduced in April's Financial Services Act 2010, has been brought into effect. The power is rule-making only, meaning that the FSA must undertake a cost-benefit analysis and consult each time it wants to establish a redress scheme. It is envisaged that it will be used in instances when there is evidence of widespread or regular failings that have caused consumer detriment.

Under a consumer redress scheme, a firm may be required to:

- investigate whether, on or after a specific date, it has failed to comply with particular requirements that are applicable to an activity it has been carrying on;
- determine whether the failure has caused (or may cause) loss or damage to consumers;
- determine what the redress should be in respect of the failure; and/or
- make the redress to the consumers.

Sally Dewar, the FSA's managing director of risk, has been quoted as saying that "the power would obviously be used proportionately. It is not a substitute for working with industry where there is the potential to bring an issue to a fair and speedy conclusion".

Click here for a press release from the FSA.

FSA publishes Consultation Paper 10/23: 14 October 2010

The FSA's Decision Procedure and Penalties Manual and Enforcement Guide review 2010 was published in October and is open for response until 14 December. It seeks views on various proposed amendments, including the proposed introduction of a new rule in the General Provisions module that an authorised firm must not pay a financial penalty imposed on a present or former employee, director or partner of the firm or an affiliated company on their behalf. Other proposals include a review of the FSA's policies on the publication of decision notices and press releases, applying the settlement discount scheme to the length of periods of suspension, and updating existing policies to ensure they are consistent with recent amendments to FSMA or other legal developments.

A Response Paper will be published at the end of the consultation process.

The Consultation Paper is available here.

EU: News

Increased regulatory enforcement

During a recent speech in Brussels Mr. Michel Barnier, the European Commissioner for Internal Market and Services, emphasised that EU supervisory authorities can only ensure that the internal market works properly if they have at their disposal appropriate sanctioning powers and if these are applied consistently across Europe. He noted that, today, sanctions still differ significantly in Europe and that, in addition, investigative tools can be tough in some countries while virtually absent in others. According to Mr. Barnier, this leaves too much scope for regulatory arbitrage, putting financial stability at risk and potentially harming consumers. He therefore saw a need to upgrade the sanctions regime to develop a more effective, coherent and dissuasive sanctions regime in the EU. The Commissioner will deliver a formal communication on this topic in the next few weeks to national authorities.

France: News

Financial Services Regulation adopted and published: 24 October 2010

New settlement power for the Autorité des Marchés Financiers ("AMF")

As reported in the September Issue of Regulatory Investigations Update a new article L. 621-14-1 has been introduced in the French Monetary Code ("FMC") by the new Financial Services Regulation adopted on 22 October and published two days later (the " Regulation"), pursuant to which the Autorité des Marchés Financiers ("AMF") Board can offer to enter into a settlement (*composition administrative*) with the relevant individual/company at the time of serving a notice setting out the grounds for the commencement of enforcement proceedings (the "*Notification de griefs*"). The purpose of the settlement is to reduce the number of regulatory proceedings in relation to minor offences. Market abuse offences are therefore excluded from the scope of the settlement provisions. Although the draft regulation proposed that the settlement would not amount to an acknowledgment of liability on the part of the relevant party and that any documents exchanged in the context of the settlement process would be excluded from use in other proceedings, neither of these provisions was maintained in the final version of article L. 621-14-1 of the FMC. Unlike FSA or SEC settlements, there are no provisions for discounting fines when agreeing a settlement with the AMF.

Other main changes to the AMF prerogatives and regulatory proceedings

In addition to the AMF's power to settle, the new Regulation introduces some other changes to the AMF prerogatives and regulatory proceedings, including:

- A wider scope of investigation

In anticipation of the next revision of the Market Abuse Directive, the AMF is now responsible for supervising the operations made on credit derivatives. Articles L.621-15 and L.621-17-2 of the FMC have been modified accordingly.

- Tenfold increase in fines

For offences committed after 24 October 2010 the maximum amount of fines that the AMF can impose is €100M on entities and €15M on individuals, or ten times the amount of the profits made. Article L.621-3 of the FMC has been modified accordingly.

- Right to attend hearings before the Enforcement Committee

A new provision in Article L.621-15-I of the FMC permits a AMF Board member involved in the investigation and in the decision to open sanction proceedings to be present at the Enforcement Committee hearing. The Board member is allowed to make observations on the grounds notified and to propose a sanction but he/she has no deliberative voice.

- Hearings to be held in public

Enforcement Committee hearings will now be heard in public as a general rule. However, parties may request that the hearing is heard in private, for certain reasons such as public policy, national security or business confidentiality.

- Right to appeal

As is the case for the individual/company on whom/which fines have been imposed, the AMF chairman has now the right to appeal the decision rendered by the Enforcement Committee, after the AMF Board's approval.

AMF publishes guide on the prevention of insider dealing: 3 November 2010

This Guide is the result of the work of a Commission chaired by the AMF Board Member, Bernard Esambert. Linklaters took part to the discussions of this commission, together with representatives of listed companies, financial institutions and professional associations. It is intended that the AMF will review the Guide on a regular basis, and will amend it when necessary. The Guide is divided into three main sections. The first section sets out the rules applicable to primary insiders and, in particular, the prohibition against disclosing inside information. The second section lists the preventive measures that the AMF recommends. The third section deals with trading plans (i.e. prearranged trading contracts that specify the amount, time and date on which securities are to be purchased or sold, concluded at a time when the insider does not possess material non public information). The insiders can establish that they have no liability if the transactions occurred under such plans.

The Guide is available here. Click here for the AMF power point presentation (both in French).

Luxembourg: News

New anti-money laundering Law passed: 13 October 2010

On 13 October 2010 the Luxembourg Chambre des Députés passed a new law aimed at strengthening the Luxembourg laws applying to the fight against money laundering and terrorist financing (the "Law"). The Law comes into effect on 7 November. It introduces two new laws and provides for a number of amendments of the Criminal Code and the Criminal Proceedings Code, as well as of 21 other specific laws (including those concerning the financial sector, the insurance sector and certain professionals, such as auditors, chartered accountants, lawyers and notaries), including the law on the fight against money laundering and terrorist financing of 12 November 2004 ("the AML Law").

The main features of the Law are the introduction of a stand-alone money laundering offence in the Criminal Code and the creation of a broader list of professionals falling into the scope of the AML Law in order to include, among others: insurance and re-insurance companies and their intermediaries when they enter into credit or guarantee transactions; managers and advisers of collective investment funds; investment companies in risk capital and pension funds.

The sanctions applicable to professionals who are knowingly in breach of their obligations are harsher than previously: a fine of up to €1,250,000 can be imposed (instead of the current maximum of €125,000), or even imprisonment for up to five years, and the range of administrative sanctions that can be imposed by the Commission de Surveillance du Secteur Financier has been extended to include, for example, publication of the sanction. Generally speaking, all penalties have been increased in order to be more effective and strengthen their deterrent effect.

US: News

SEC charges hedge fund and manager with fraud: 25 October 2010

The Securities and Exchange Commission ("SEC") has filed a civil enforcement action against Southridge Capital Management LLC, its founder Stephen Hicks, and his investment advisory company Southridge Advisors LLC. The complaint attempts to shine light on the typically secretive operations of hedge funds, and charges Hicks and his management and advisory companies with attracting investors by misrepresenting the liquidity of funds, over-valuing assets, charging excessive management fees based on the over-valuation of assets, and wrongfully using fees to pay operating and legal expenses. Although the SEC, in the wake of the Madoff scandal,

has focused on so-called Ponzi schemes, the hedge fund registration, record keeping, and inspection provisions of the recently-enacted Dodd-Frank Wall Street Reform and Consumer Protection Act have given the Commission the tools to investigate and pursue claims like those brought in Southridge. The possible trend toward investigating the wrongdoing of hedge fund managers also signals the Commission's interest in pursuing violations of United States securities laws regardless of whether the victims are small investors or, in the case of many hedge fund investors, large entities and highly sophisticated individuals.

The case is *SEC v. Southridge Capital Management LLC*, No. 10-1685 (D. Conn). Click here for the SEC's press release announcing the charges, including a description of the conduct that allegedly amounts to fraud.

Lindsey Manufacturing Co. indicted for conspiring to bribe Mexican officials: 21 October 2010

On 21 October 2010 Lindsey Manufacturing Company became the first company since September 2008 to be criminally indicted for violating the Foreign Corrupt Practices Act ("FCPA"). Despite reports that Lindsey Manufacturing was cooperating with authorities, the company and two of its executives were charged in an eight-count, superseding indictment with violating, and conspiring to violate, the FCPA. The indictment follows an early indictment of two individuals acting as sales representatives and alleges that, between February of 2002 and March of 2009, executives from Lindsey Manufacturing conspired to pay bribes to Mexican officials. The criminal charges carry millions of dollars in potential fines and decades of prison time, but more importantly for the company they may result in its collapse. Criminal indictments of companies are rare, with violations of the FCPA usually resulting in some form of agreement with the government (e.g. a plea agreement, deferred prosecution agreement, or non-prosecution agreement). Here, the indictment is even more surprising as Lindsey was reportedly cooperating and claimed to have no knowledge of any improper payments.

The indictment may mark a shift in the government's treatment of FCPA violations, such that the Department of Justice ("DOJ") will no longer be willing to allow companies and their executives to enter into plea agreements that are viewed by the public as favourable to the defendants.

Going forward, this case may test the limits of who could be considered a foreign official under the FCPA. Lindsey allegedly conspired to bribe senior employees at Mexico's *Comision Federal de Electricidad*, which, according to its website, is a "decentralized government agency, duly incorporated and which controls its own assets." Whether these senior employees qualify as "foreign officials" is yet to be seen, but a challenge to the DOJ's claim that they are could provide a long-awaited vehicle to test the scope of the FCPA.

The case is *United States v. Noriega*, 10-1031 (C.D. Cal.). Click here for the DOJ's press release announcing the indictment.

Hong Kong: News

Courts and regulator continue tough stance on market misconduct in Hong Kong

The past two years have seen a paradigm shift in the approach adopted by the Securities and Futures Commission (SFC) in its investigations, with use being made of previously untested statutory powers to freeze assets, compel production of documents and record interviews with employees. Insider dealing has been top of the SFC's agenda throughout. However, it was not until 2008 that the SFC brought its first criminal prosecution for insider dealing (some five years after the offence was added to the statute books). The convictions of five individuals in the case of *HKSAR v Sammy Ma Hon Kit and others* (Criminal Appeal no. 148 of 2009), one of whom was a banker who passed inside information to his girlfriend and family in relation to a deal on which he was advising, were secured over a year later. Fines were imposed on each and sentences of imprisonment were passed in respect of the two main parties. Last month, Hong Kong's Court of Appeal refused leave to appeal against the convictions of two of the five. The Court of Appeal was satisfied that the irresistible inference to be drawn from the trading activities of these family members was that they had received inside information from the banker.

Other insider dealing cases have been handled through the Market Misconduct Tribunal (MMT), a specialist civil forum with enhanced 'penalty' powers. Findings of insider dealing were made last year by the MMT against a banker and two fund managers who had traded ahead of a placement in which the banker was involved. The Tribunal recommended that the SFC impose disciplinary penalties on all three. The SFC subsequently revoked their licences for life. One of the fund managers did not appeal. The banker's appeal was determined last month by the High Court which reiterated the seriousness with which the courts view insider dealing as a form of dishonest misconduct, even where no immediate pecuniary benefit is obtained. The licence revocation was confirmed but reduced from life to a period of 10 years.

Click here for the Court of Appeal judgment in *HKSAR v Sammy Ma Hon Kit and others* (Criminal Appeal no. 148 of 2009, 12 October 2010.

New resource

The new Linklaters Regulatory Investigations & Enforcement microsite

Following the success of the International Reform of Financial Regulation microsite, a new microsite focusing purely on regulatory investigations and enforcement is currently being developed. Our aim is to keep our clients up to date with information and practical guidance in this constantly changing field. The site will launch initially with the following topics: Internal investigations, FSA investigations, FSA enforcement proceedings, Bribery and Corruption, Market Abuse and Insider Dealing and Mis-selling (retail and institutional). Content will be regularly updated and we welcome any feedback you have.

You will receive an email alert notifying you when the site is launched.

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