TOPICAL ISSUES FOR
PE FUND MANAGERS

EVERYTHING BUT THE DEAL

WHAT'S INSIDE?

TAXING TIMES
Increased emphasis on self-policing for tax compliance

ARE YOU BEHAVING?
FCA puts culture and governance under the spotlight

INTERNAL AFFAIRS
Practical tips for internal investigations

ADDLESHAW GODDARD

"BUSINESSES THAT TAKE DECISIONS BASED ON THE RISK OF BEING FOUND OUT REALLY NEED TO THINK AGAIN.

This latest edition of Everything But The Deal offers an extensive practical guide from colleagues in our Global Investigations team on internal investigations. Its fair to say we've seen exponential growth in this area over the last five years, across a full range of corporate clients. What was historically more usually limited to businesses operating in high risk jurisdictions or sectors has very much entered the mainstream, and whilst macro culture shifts and campaigns account for some of this there is no doubt that legislation and regulation is expanding the need for private equity funds, and the portfolio companies in which they are invested, to keep themselves in check irrespective of the extent and nature of their operations. The old ways of doing business are clearly no longer good enough.

A look across the other content in this issue really hammers this point home. Whilst the tax change that most UK PE funds were focussed on (i.e. CGT rates) didn't come to pass in the budget, announcements concerning the continued drive towards disclosure of "uncertain tax positions" and updated transfer pricing reporting requirements give two further examples of how HMRC are increasingly putting the onus on larger businesses to monitor themselves and hand over the data that HMRC may require to either enforce current legislation or legislate for the future. GPs not only face pressure from their LPs to get their ESG into shape, but also from their regulator – with the FCA stating that they feel it is entirely within their remit to focus on non-financial as well as financial misdemeanours. Strap lines on websites are clearly no longer going to be good enough, so the question of how all this can be managed and monitored by investors on a portfolio-wide basis as well as within their own business has rapidly made its way onto the Top 5 list of many of our PE clients one way or another.

Most people think of contacting our investigations specialists when significant issues surface, but prevention is always better than cure. By offering some high level guidance on the steps that need to be taken to conduct a good investigation, we hope that readers will take away some ideas to inform systemic changes, as well as a blueprint for action where investigations are needed. In an environment that increasingly asks businesses to regulate themselves, robust and defensible action may well avoid not only financial but also reputational consequences, for businesses and their investors alike.

As always, we are happy to share our experience here to help our clients and contacts. If your reading on these topics leaves you feeling like you could have some better plans in place, rather than waiting for problems to surface, do get in touch.

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THE TAX TAKE

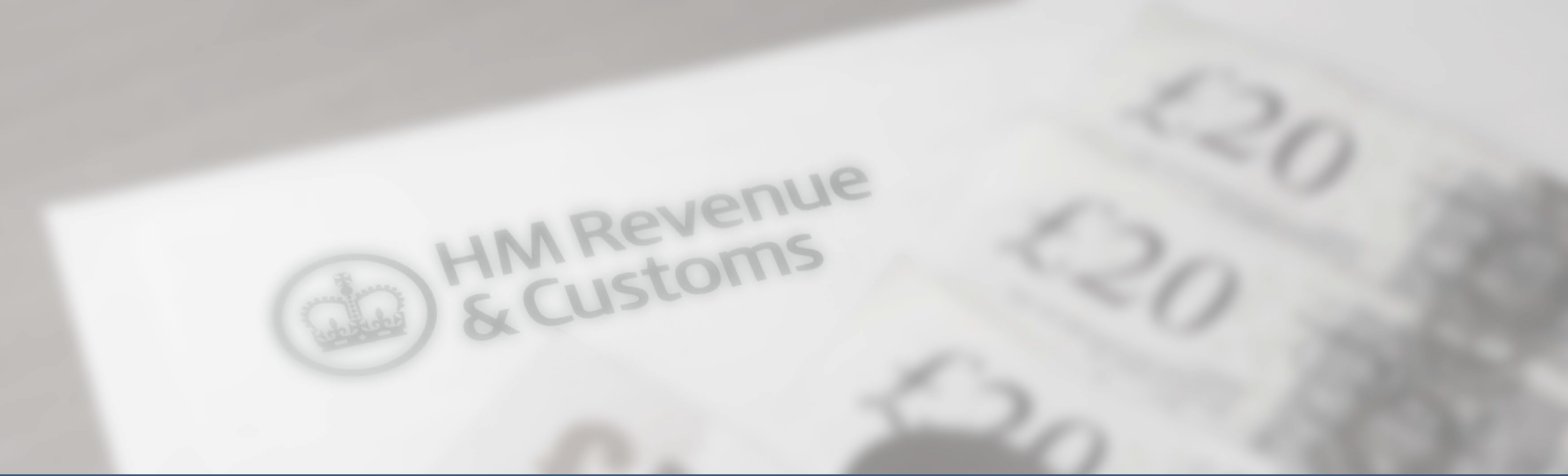
THE BIG PICTURE

Since we last talked, the Budget has been and gone. Fairly uneventful, certainly in the light of expectations about radical changes to the CGT regime. Absent was the long-feared increase in rates; absent even an announcement that the Office of Tax Simplification recommendation of regime change would be duly considered. So, still hiatus.

But there were tax announcements, for example the introduction of a requirement for large businesses to notify HMRC of "uncertain tax positions" (more on this below). Directly relevant to large businesses, which will be required to let HMRC know if they take tax positions in returns which aren't consistent with market practice or HMRC guidance but also significant as the latest in a long line of measures introduced in recent years intended to force taxpayers and their advisors to police their own tax affairs.

In the past, HMRC assessed and collected tax, enquired into and investigated tax anomalies and irregularities. The first step change was the introduction of self-assessment for businesses and individuals but in more recent years, the trend has developed with increasing obligations imposed on businesses. Initially, to inform HMRC of tax planning schemes and tax 'products' adopted (with the "Disclosure of Tax Avoidance Schemes" rules), a regime which extends to tax advisors. The Code of Practice on Taxation for Banks introduced in 2009 requires financial services signatories to commit to eschewing the financing of transactions which involve any attempted reduction or deferment of tax. Then, from 2016 larger businesses have been required to publish their "Tax Strategy", to publicly declare their good intentions in relation to tax, as a mirror against which their business activity is reflected. And the new proposal for businesses to inform HMRC of uncertain tax positions is the latest development.

Many of these measures are ostensibly designed to provide the Revenue and Treasury with the information needed to adapt legislation to an ever-changing global and digital business landscape. But combined with the increasing reputational risk associated with even the innocent organisation of tax affairs (such as the legitimate utilisation of losses), surely the intended effect is to force businesses to adopt increasingly conservative (perhaps unnecessarily



conservative) positions and to be sure to clear everything with their CRM.

Yes, things needed to change. There's no doubt that it was too easy for certain companies to manage their tax affairs to reduce taxable profits in higher tax jurisdictions, for businesses and individuals to utilise reliefs intended to stimulate investment and entrepreneurialism in order to shelter disproportionate gains. But is the pendulum swinging too far the other way?

Tax is becoming an ethical (an ESG) issue – an issue which is judged, by the media and public, along with D&I, environmental, and CSR credentials. As the tax manager at a corporate client said to me, not too long ago – "we need to be seen to be exceeding, not just meeting, our tax obligations." Tax IS CSR?

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TAKING OFF – WHAT'S NEW?

UNCERTAIN TAX POSITIONS

The first consultation (initiated last year) on this topic was met with general criticism and concern from tax payers and tax advisers alike. Undaunted, the Government is pressing ahead with its proposals for "large businesses" to be obligated to notify HMRC if they are taking "uncertain tax positions". This measure is designed to address the perceived tax "loss" arising as a result of "legislative uncertainty" by making tax payers specifically highlight areas which may be more vulnerable to HMRC challenge / investigation.

The provisions build on (but are separate to) existing obligations on tax payers to notify HMRC of arrangements which may be considered to fall within "grey" areas of the law, although to date such obligations have (in the main) focused on "avoidance".

"Triggers" which will oblige a large business to make a report to HMRC are set out in the second consultation, those "triggers" include:

- adopting an interpretation of tax law that differs from HMRC's known position, or departs from established industry practice, or conflicts with the position taken in a previous tax return;
- unusual situations where there is no "market view" on the applicable tax treatment;
- where there is a difference between the tax outcome and the underlying economics; and
- where the approach taken is based on advice that differs from other available advice, or where the approach is taken despite the availability of advice suggesting a different tax treatment.

The last trigger, in particular, is widely drawn and could lead to unintended consequences (such as companies deliberately not taking external tax advice which can't be good for tax compliance more generally).

Taking a step back, it is difficult to understand why this is an area of continued focus for HMRC as a lot of "large businesses" already have their own CRM. The advantage of having a CRM is that it gives those businesses an ability (and means) to discuss and agree "grey areas" with HMRC. The consultation confirms that where business is already in dialogue with HMRC on a particular matter, there would be no additional obligation to notify HMRC of the same matter under these proposals. Perhaps this is the point of the proposals – not for HMRC to receive vast numbers of notifications under this new regime but to encourage large business (through the use of this "stick") to discuss and agree points with HMRC upfront.

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UPDATING TRANSFER PRICING DOCUMENTATION REQUIREMENTS

"Now, what I want is Facts....Facts alone are wanted in life." (Charles Dickens, Hard Times).

A consultation about transfer pricing documentation. Hmm, not the most exciting of topics (more red tape) until you think about why HMRC is interested in this. Why because, having put reporting and assessment obligations onto taxpayers and their advisers, HMRC needs to be sure it is getting all the facts. Everybody else is data mining, why would HMRC not be doing it?

Currently our tax rules only impose "non-specific" record-keeping requirements, the consultation document explains (there is an obligation to maintain records needed to deliver correct and complete returns – which seems pretty all-encompassing but maybe there are gaps in record-keeping where taxpayers think they don't fall within particular tax rules?). HMRC is adopting an "efficient risk-based approach to cooperative compliance" but aware of the importance of access to information and data in "areas of significant risk like transfer pricing" (and has made over £6bn from TP compliance in the last 5 years, according to the consultation document).

It's been 5 years since the UK introduced a minimum standard for transfer pricing documentation, in line with BEPS Action 13, and HMRC has noticed that other tax authorities around the world are getting more information, in more useful formats – the consultation includes, by way of examples, forms required by Australia (24 pages), Belgium (13 pages) and Denmark (1 page).

The main suggestion being mooted is a requirement to keep specific TP documentation and to include information about material cross-border transactions in tax returns. This might take the form of a master file, a local file, an international dealings schedule (**IDS**) and/or evidence log. Companies with no material cross-border transactions might have to make an annual declaration to this effect.

The carrot (pretty small): a specific documentation requirement would reduce uncertainty for taxpayers. The stick (bigger): failure to produce the master file and local file within 30 days would be taken into account in considering whether reasonable care had been taken in preparation of the relevant tax return.

The target taxpayer base would be taxpayers subject to country by country reporting. SMEs and UK-to-UK situations would be excluded and reporting could be done by a group member on behalf of a UK group. If an IDS is required, the aim is to make the format user-friendly for data mining.

As both this consultation and the one mentioned above demonstrate, the impact of an increasingly global and collaborative approach to taxation is producing on-the-ground change for taxpayers. Exchange of information is here to stay and we should expect HMRC to continue to upgrade its own toolkits in line with what it is seeing elsewhere. Existing requirements in other jurisdictions are shaping UK proposals – this is true of both the TP documentation and 'uncertain tax position' proposals - and changes to UK requirements will in turn impact taxpayers in other jurisdictions (for example, if information provided to HMRC under TP or 'uncertain tax position' reporting is exchanged with other tax authorities).

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TAX AT STAKE

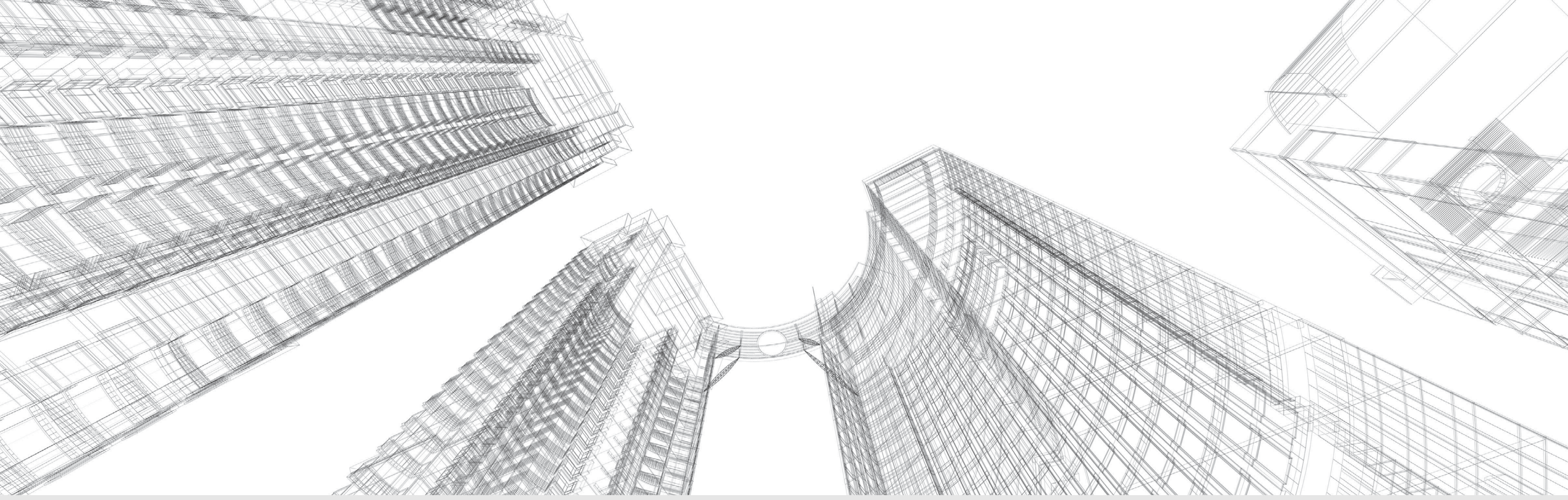
FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

Continuing with the theme of egregious tax behaviour, we continue to be engaged by investee and portfolio companies to advise on the offence of failure to prevent facilitation of tax evasion, which often crops up in due diligence. Post-acquisition, PE investor clients are keen to ensure that any (potential) wrinkles identified in due diligence are ironed out and our role can range from a simple "health check" to a full and detailed assessment of the investee company's policies and procedures, together with a plan to ensure the company has adequate procedures in place going forward to prevent an associated person committing the criminal facilitation offence.

Previously, prosecutors had to show that the senior members of the relevant body were involved in and aware of illegal activity in order for criminal liability to be attributed to the relevant body. The Criminal Finances Act 2017 introduced the new offences of failure to prevent facilitation of UK or foreign tax evasion which essentially reversed the burden of proof. Where employees or contractors of a company or partnership are involved in facilitating offences of (criminal) tax evasion, the company or partnership itself will also be committing that offence unless it can show that it has put in place reasonable preventative procedures.

There are three stages for a company or partnership to be guilty of a criminal offence:

1. criminal tax evasion by a third party taxpayer (either an individual or a legal entity) under existing law;
2. criminal facilitation of that tax evasion, by an "associated person" of the relevant body acting in that capacity;
3. failure by the relevant body to prevent its representative ('associated person') from committing the criminal facilitation act.



For portfolio companies, the main thing is to ensure that they are able to demonstrate that they had "reasonable prevention procedures" in place to try to avoid any potential tax evasion by associated persons. This is the only defence to the strict liability offence (punishable by way of an unlimited fine, as well as reputation damage) and is a matter of fact.

It goes without saying that certain types of businesses are naturally more at risk than others, for example, financial services businesses, but all businesses are subject to the rules. So it should come as no surprise that PE investors want to make sure their portfolio companies are doing all they can in that regard, particularly in a post-pandemic world where such companies may have experienced significant businesses disruption and increased use of government financial support schemes, whilst at the same time having less control over their "associated persons" who may have been working from home under increasingly stressful circumstances.

Hats off to you if you are reading this and thinking "we've done all this already". If you have, it's worth remembering that HMRC expects businesses to review their prevention policies and procedures on an ongoing basis and particularly when the business has undergone change. Indeed, now may be the perfect time to carry out your annual health check.

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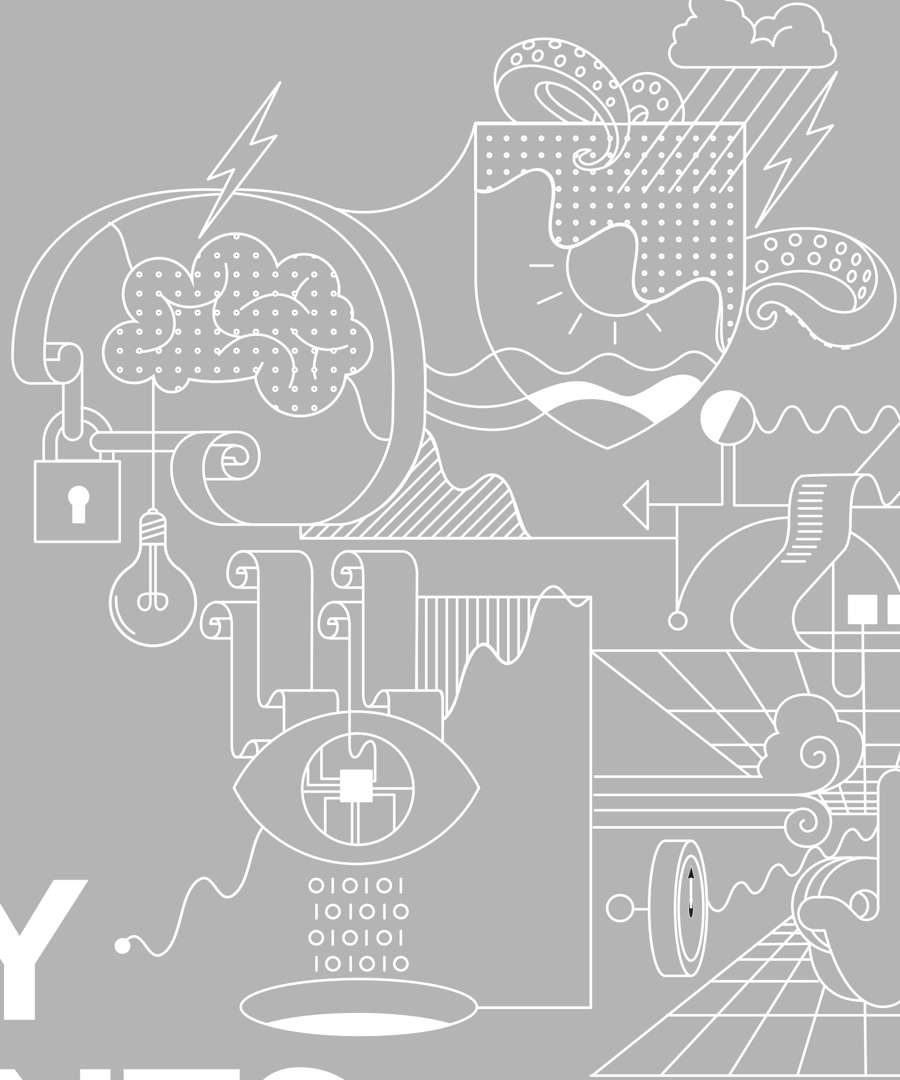
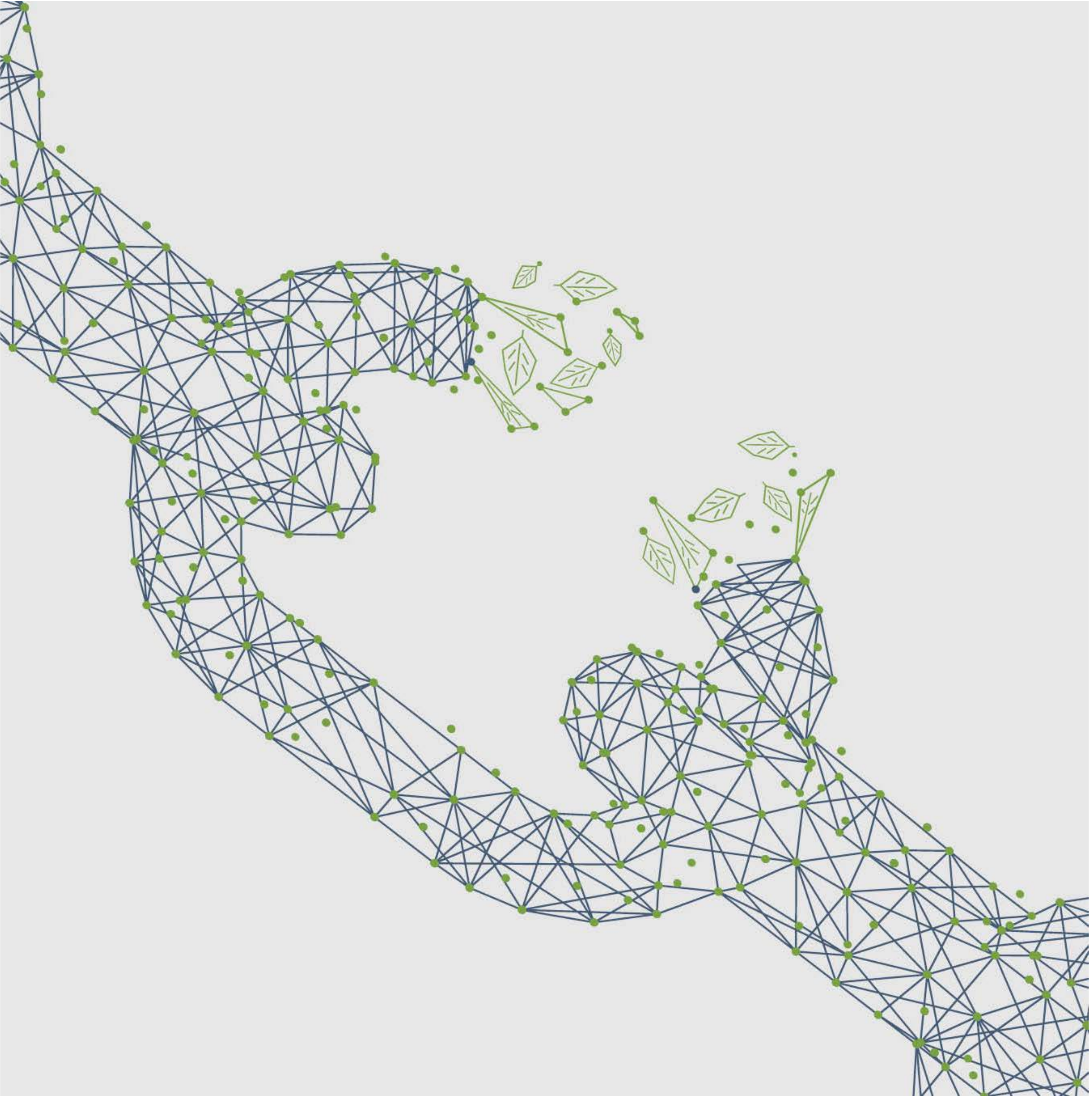


2 REGULATORY DEVELOPMENTS



Bracing for ESG Impact

ESG considerations have now gone firmly mainstream when it comes to PE investing – driven by investors' demands, the desire to make a positive impact on society and hard-nosed financial considerations.

This, together with increased regulatory scrutiny, is throwing up new opportunities and challenges for GPs and LPs.

Coming soon: PE focussed ESG insights

Over the last three months, we have conducted interviews with GPs, LPs, fund finance providers and other stakeholders, looking at trends, challenges and opportunities in ESG investing.

We look forward to sharing our report with you this summer, including insights on:

- how GPs are positioning themselves to make a positive impact on society and combining this with financial returns for investors
- emerging ESG related commercial

terms in private funds, such as linking carried interest to the achievement of impact targets

- the increasingly complex regulatory landscape and whether it helps or hinders attaining ESG goals

We will also share key findings from ITPEngerised and Orbis Advisory's Private Equity Transparency Index.

Pain to Net Gain – Exclusive insights from 1,000 senior business and finance leaders

Our forthcoming PE focussed report supplements our recent market research on "Sustainability: Pain to Net Gain" that saw us speak to 1,000 senior business and finance leaders across the UK and Europe.

Our research found that financiers – including PE funds and asset owners – are becoming the new activists with:

- 86% of business leaders reporting that they have been driven to act more sustainably by their investors

- 99% of investors asking for evidence of sustainability performance.

You can access all of the research findings here, together with recordings of past, and registration details for forthcoming, panel discussions exploring key areas of our research findings.

With the continued focus on ESG by managers, investors and regulators alike, we hope that our insights and materials, will be a helpful tool to navigate this complex terrain.

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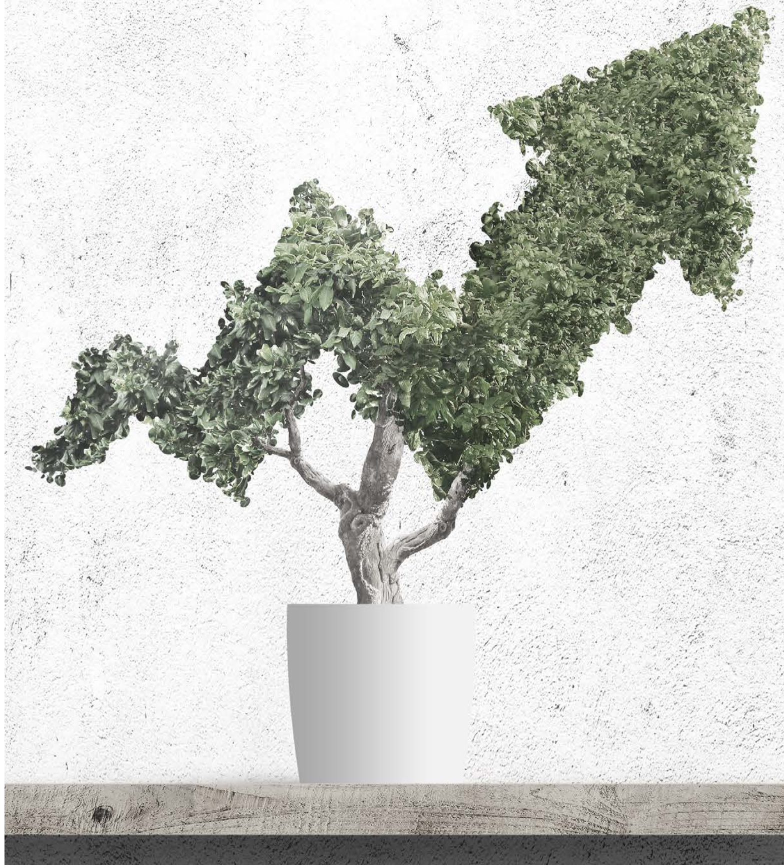


ARE YOU BEHAVING? FCA PUTS CULTURE AND GOVERNANCE UNDER THE SPOTLIGHT

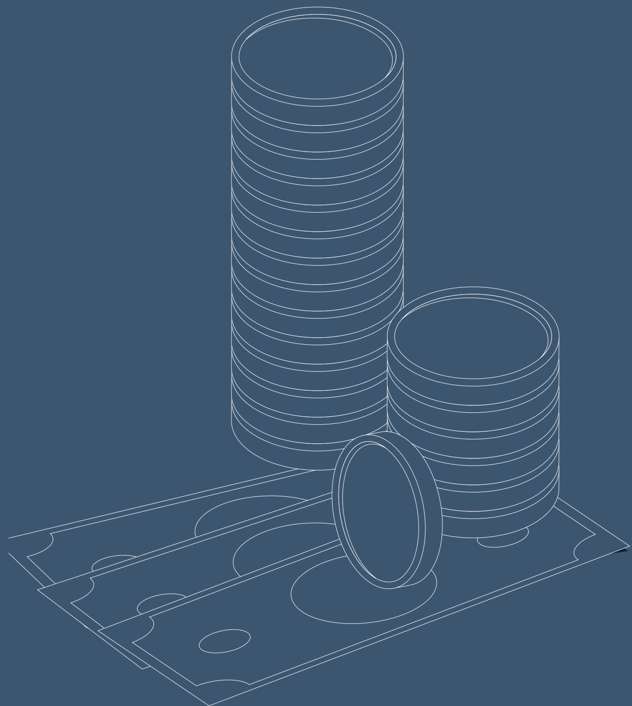
There have been several material corporate governance developments over the last few months that private equity firms should be aware of. First, the FCA have raised a number of interesting existentialist questions around corporate purpose, governance and culture. And second, in a series of Final Notices, the FCA has made it clear that it expects firms to treat non-financial misconduct as seriously as financial misconduct.

Corporate purpose, governance and culture

In a speech given in September 2020 to the Investment Association's Culture in Investment Management Forum, Marc Teasdale, the FCA Director of Wholesale Supervision spoke to the FCA's strong focus on the role of healthy firm cultures in producing positive outcomes for consumers and markets. The text of the speech can be found here. He defined 'culture' as the "*habitual behaviours that characterise an organisation.*" He noted that in the FCA's view, corporate purpose, governance and culture are fundamentally entwined and that "*[f]irms with healthy cultures demonstrate strong governance that supports the daily delivery of their essential purpose.*"

Four drivers of culture were identified:

- leadership: essentially the tone from the top and how that cascades through the firm;
- people policies: how behaviours are incentivised and disincentivised in the firm;
- governance: how decisions are made; and
- purpose: which the FCA sees as the fundamental driver of culture.



Purpose, on one level, could be seen as just a description of the firm's business model. But in the FCA's view "*in order to understand how a firm's purpose drives its culture, you need to understand … its reason for existing.*" Teasdale goes on to contrast two firms. Firm A's purpose is to "*maximise the returns of its shareholders by being the biggest ECM player*" whereas Firm B's purpose is to "*support the sustainable growth of companies that provide jobs and services to the wider economy.*" In essence, the FCA is asking firms to think about the social and/or economic contribution that it makes.

Governance is defined by the FCA more widely than just the board and senior management – it includes the broader set of processes, systems and controls by which decisions are made and the business advances. The FCA notes the importance of the tone from the top, especially given that tone cascades through organisations. An emphasis is also placed on how people policies drive culture.

Finally, echoing the PRA's views in its March 2020 Dear Chair letter (text available here), Teasdale made it clear that diversity and inclusion at all levels, not just in the board, leads to more successful identification and management of risks and better decision making.

Whilst the speech was principally aimed at the traditional asset management industry rather than specifically at private equity houses, it is an important indicator of the FCA's approach to governance and culture in firms. And as Teasdale pointed out, corporate purpose should be more than "just a slogan on a brochure" – private equity houses should be able to articulate their purpose and how that is embodied in the firm's governance and culture.

Non-financial misconduct

In November 2020, the FCA published Final Notices in relation to non-financial misconduct by three individuals (available here). Each of the three had been convicted of serious sexual offences while working in the financial services industry and as a result all three individuals have been prohibited from performing any function in relation to any regulated activity carried on by an authorised person.

Over a series of Dear CEO letters and speeches in recent years, the FCA has made it clear that a firm's attitude to non-financial misconduct can be taken as a proxy for the firm's approach to the its culture. In a January 2020 Dear CEO letter to the insurance industry (available here) for example, the FCA noted that: *"[h]ow a firm handles non-financial misconduct throughout the organisation, including discrimination, harassment, victimisation and bullying, is indicative of a firm's culture."*

Policing the actions of partners, directors and employees inside the work place is challenging enough, but private equity houses should also be making clear their expectations regarding acceptable behaviour outside of the office environment. As such, firms should, to the extent that they are not already doing so, ensure that their training extends to their expectations in relation to non-financial misconduct both inside and outside of the workplace.

Conclusion

Driven by a number of factors, ESG, COVID-19 and increased regulatory scrutiny, governance should continue to be towards the top of private equity houses' agenda. Whilst not (yet) baked into black letter law, private equity houses should seek to be able to not only articulate their purpose but also demonstrate how that purpose is driven by its leadership, people policies and governance. Finally, firms should make sure their partners, directors and employees are aware of their expectations in relation to non-financial misconduct.

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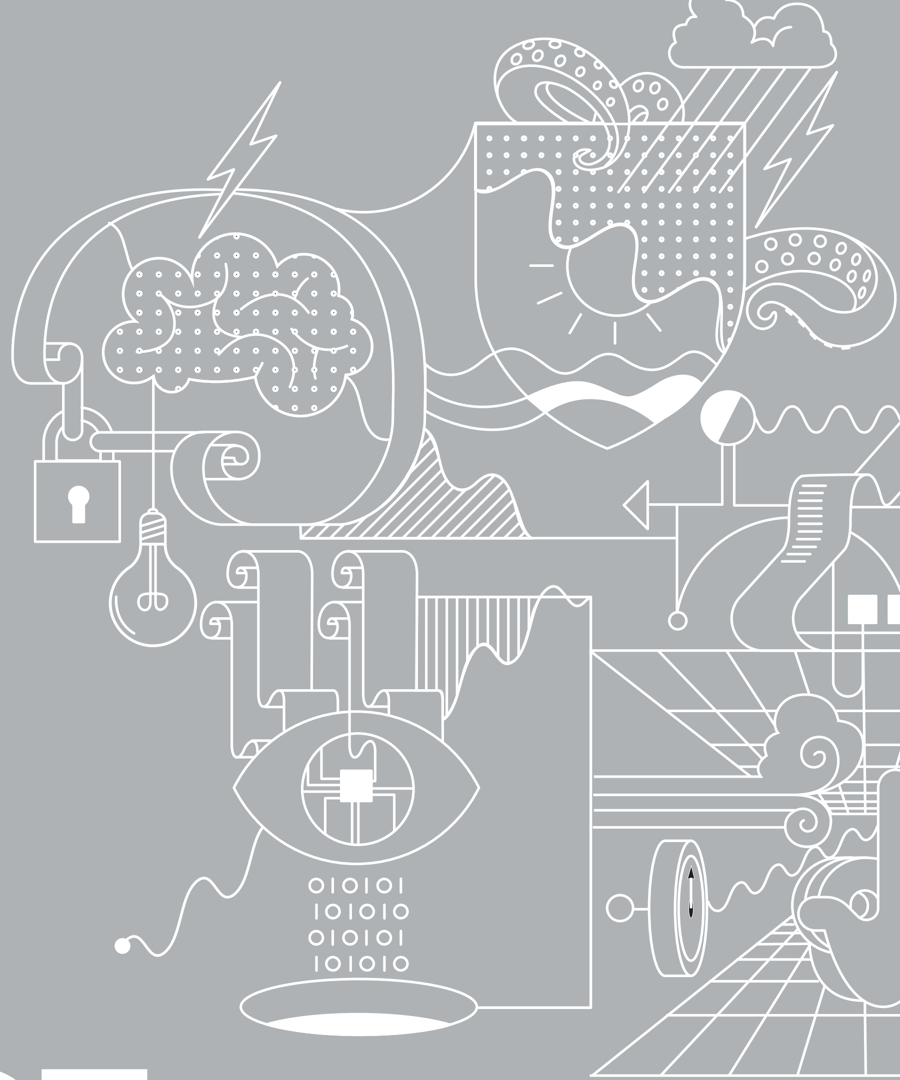

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CORPORATE GOVERNANCE

INTERNAL AFFAIRS

INVESTIGATIONS AS A TOOL OF CORPORATE GOVERNANCE

Companies regularly undertake internal investigations in order to identify and manage risk and to demonstrate good corporate governance. In the area of economic crime risk, investigations are a fact of corporate life. When concerns about corruption or other forms of business crime surface, the board will typically appoint lawyers to conduct an independent investigation and advise the company on its response to legal risks. Internal investigations are also increasingly used to examine wider issues of governance, culture and conduct, often on sensitive issues. What amounts to good investigations practice is developing all the time.

Corporate governance has gained in importance in the area of economic crime since the UK Bribery Act 2010 and the Criminal Finances Act 2017 introduced the concepts of 'adequate procedures' (in the case of bribery) and 'reasonable prevention procedures' (in the case of the failure to prevent the facilitation of tax evasion) as defences to certain crimes.

An investigations process forms part of a company's overall prevention procedures and directors exercising oversight obligations in relation to investigations should satisfy themselves that investigations are independent and appropriately robust. The adequate / prevention procedures guidance also emphasises the importance of 'top-level commitment' to compliance.

As regulatory pressures increase on auditors, we see them begin to focus more, in audits of larger and listed corporates, on governance around the accounting and audit process. The press coverage of institutional shareholders becoming more activist has similarly led to governance in some larger corporates coming under greater scrutiny. Individual conduct and culture has risen up the agenda following movements such as #MeToo and BLM, leading in some cases to an increase in whistleblowing. These factors have led corporates to look further at how to understand, measure, address and report on these issues through internal investigations.

Here we pool our experience of conducting and supporting internal investigations of all different kinds to list the issues that directors should think about when providing oversight of an investigation.

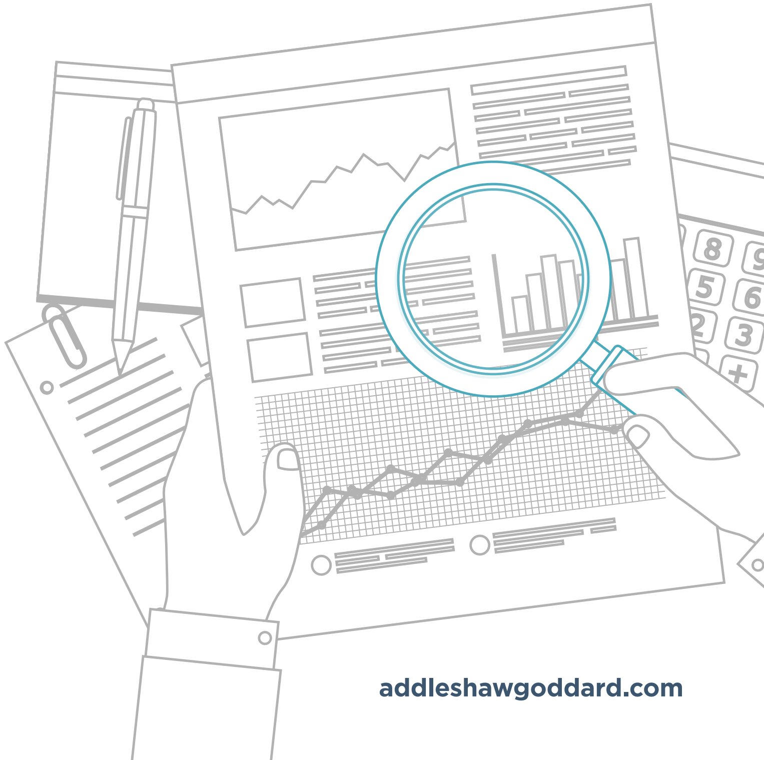
Assemble the right team: independence, confidentiality and skill set

It is important to ensure that the investigations team is independent from those under investigation. It goes without saying that the team should exclude any person who has been accused of wrongdoing. The business will need to give careful thought to the professional relationships of any investigation subjects and to identify and manage any potential conflicts of interest.

As a rule of thumb it's best to keep the investigations team as small as possible but inevitably investigations can involve a lot of stakeholders, such as IT, HR, Communications, Legal, Compliance and Internal Audit.

Confidentiality is often key to a robust investigation process and will be supported by clear communications protocols. It can also help to protect against risk of a whistleblower alleging or suffering detriment, since the Employment Rights Act 1996 provides whistleblowers with unlimited damages where they can show they have suffered detriment as a result of blowing the whistle. Investigations should be managed keeping in mind the need for discretion, minimising business interruption and ensuring sufficient objectivity or detachment.

You should also consider what independence means when appointing any external advisers, whether external lawyers, forensic accounting teams or other experts. The reality is that most companies turn to their trusted advisors to conduct sensitive or material investigations. They understand the business and its ethos and can move quickly and effectively to support the business. But views about what amounts to independence differ and may be challenged. The company will want to ensure that the investigation is appropriately described, rigorous, that the work product is objective and that the mandate that underpins the investigation supports those outcomes.



Ask yourself:

- Do we have the right people?
- Are they independent and trusted individuals?
- Is the person overseeing the investigation sufficiently senior and independent?
- Have we made confidentiality obligations and lines of communication clear?
- Which external advisers do we need?
- Have we given our external advisers a clear mandate?

Understand your audience and purpose

Be clear from the outset about who the output of the work is for and who it may be shared with. Financial services business regulated by the PRA/FCA have additional whistleblowing rules to follow, as may other professions such as solicitors. These rules form a central plank of internal investigations in these sectors.

In the report itself, it is important to avoid overstatements, exaggeration, speculation or rushed judgements. If the report is being prepared by non-lawyers, they should avoid drawing legal conclusions about the conduct under investigation. It is quite common for companies to have to give auditors access to extracts from investigation reports or sometimes to the reports themselves. If you do need to share investigation work product with auditors, finance providers or others, this should be on strict terms (see privilege, below).

Establishing a clearly defined scope of work at the outset will help to direct the work, manage costs and time, and deliver an output that is fit for purpose. Scope change can be necessary to keep an investigation useful and relevant, but focus and a careful balance will be needed to avoid unnecessary scope creep. Broadening scope will often impact on timing and may dampen the key purpose and learnings. The work can become vague and unwieldy if every hare that is set running is chased down. Equally, an overly-narrow scope may be seen as self-serving or, worse, deliver an output that begs the question. If material which is excluded from scope is necessary to assess the matters in question, the resulting work product will not achieve its aims. Robust discussions around scope review are a valid part of investigation governance.

Privilege

Legal professional privilege affords confidentiality and protection from disclosure or discovery by third parties, including regulators to communications made for the purposes of legal advice, regulatory investigation or for litigation, and can only be provided by lawyers. Where there may be sensitive legal issues, legal analysis and advice required, or the risk of litigation or employment claims, you will need to preserve your right to receive privileged legal advice without disclosing it to third parties. That does not mean that a law firm cannot produce, or be involved in producing, a report over which you would not claim privilege.

Where law or regulation is in question, there is value in having this assessed by a professional lawyer rather than a lay person. Equally, if the subject matter is heavily financial or data driven, other types of expert will be of value.

The current law around privilege and how it applies in investigations is complex. Commonly the most difficult privilege issue that arises in investigations is in relation to witness interviews. It is often necessary to speak to witnesses, but these communications may not be protected by privilege. This is because "legal advice privilege" only covers communications between client and lawyer, and the term around client is construed very narrowly in English law to mean a person authorised to give instructions and receive the advice. (The decision that established this narrow definition has been fiercely criticised for years, but we have to live with it at present.)

For communications with "third parties" to be protected by privilege, "litigation privilege" must apply. Litigation privilege only kicks in, however, where adversarial proceedings are in reasonable contemplation. The application of litigation privilege to an investigation is thus very fact specific. The strength of any claims to privilege must be properly tested and understood from the outset and may shape the strategy of the investigation.

In this jurisdiction it is possible to share privileged material with third parties without destroying the privilege in the document as against the rest of the world. If companies decide to share investigation reports or extracts of them with third parties such as auditors, it is important to maximise the level of privilege protection that endures. This is done through the mechanism of a "limited waiver of privilege". It's important to bear in mind that some jurisdictions do not have a limited waiver doctrine, so it's important to take account of the impact of sharing privileged content in all relevant jurisdictions. In addition, the Government's ARGA White Paper (explored on page 26) includes a request for views on whether the regulator should be able to obtain such material shared with auditors on a limited waiver basis as part of its investigation powers.

Data: preserving it, reviewing it, sharing it – and knowing when not to create it!

Preserving and collecting relevant data is one of the most critical steps in an investigation and if there is any business crime or civil fraud risk this should be done in a forensic way. The sources of relevant data have been multiplying in recent years with the result that specialist help is usually required to ensure a thorough preservation process. Allocating responsibility for document preservation, collection and storage needs careful consideration at the outset, including advice as to the legal restrictions on gathering and sharing data arising from data protection legislation. A plan for preserving electronic data and documents at the outset, to reduce the risk of attempted or accidental deletion, will be important to support the collection and review of material during the course of the work.

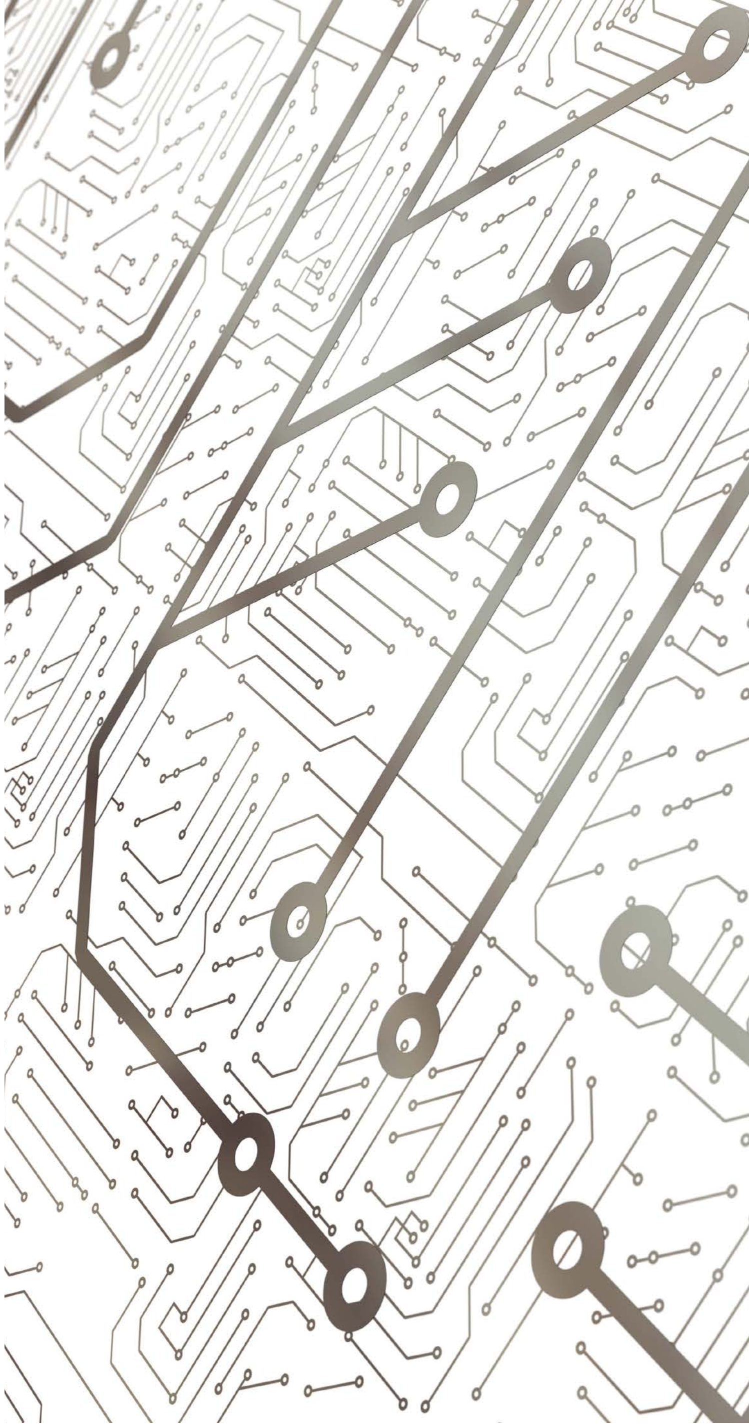
At the other end of the spectrum, it's important to avoid creating material which may fall to be disclosed and may reflect poorly on staff or the company. Consider:

- Highlighting to staff the importance of not engaging in unnecessary or speculative discussions through messaging tools, mobile phones or email.
- HR and Internal Audit may be engaged in related investigations and may not realise that their communications, including with other team members, are not protected from disclosure.
- The investigation team and committee itself thinking carefully before creating material in a way which is not legally privileged.

Investigations Governance

It is important to establish a clear governance framework around the investigation. Consider:

- an investigation sponsor to lead and direct the work;
- establishing a steering committee;
- having clear terms of reference – to establish the purpose and scope of the work;
- management information needs – to help project management and oversight;
- how the team will update senior management (and if that is appropriate);
- information sharing protocols, so that all involved are clear on who needs to review and approve what documents, communications and decisions.



Employment risks: co-ordinate closely with HR

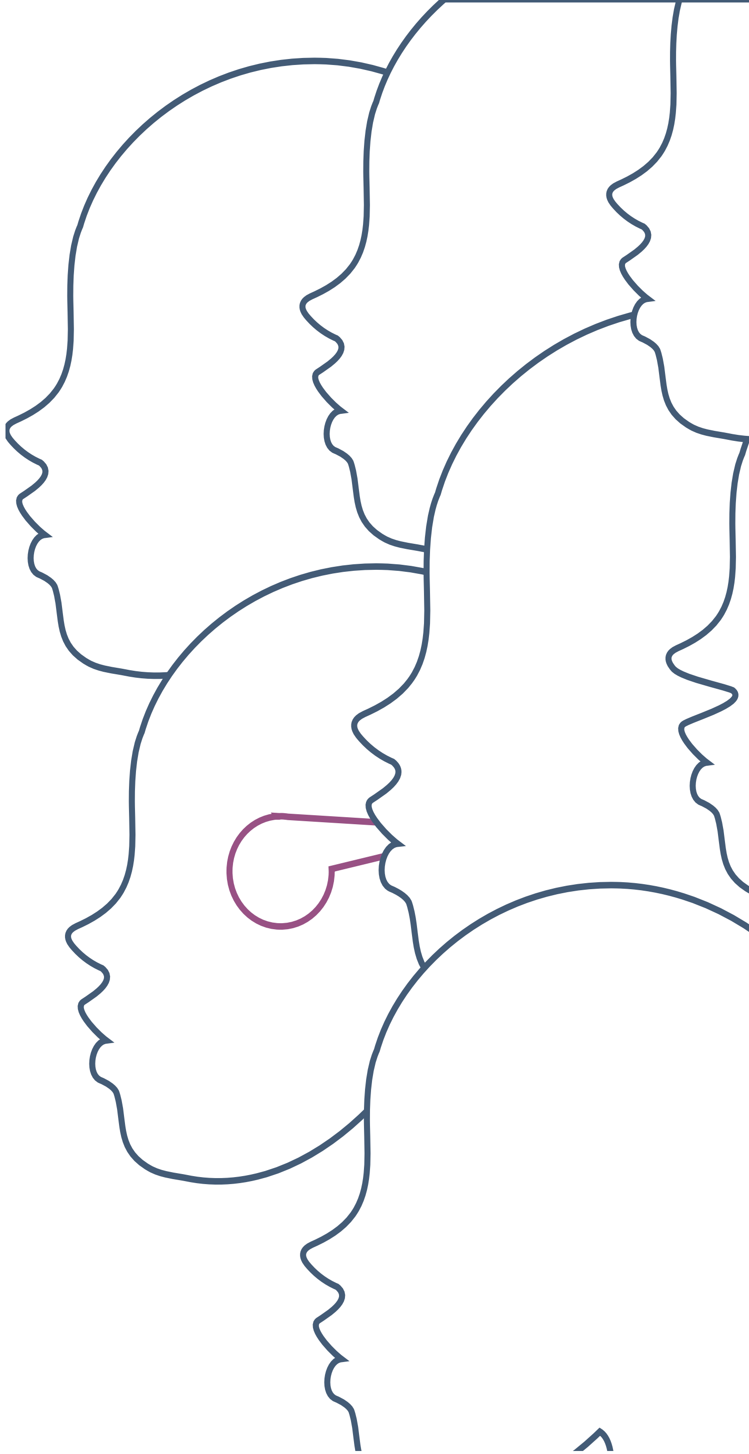
Internal investigations will often be triggered by, or involve an element of, employee conduct or whistleblowing. Companies need to ensure careful coordination with HR and employment lawyers on the employment law risks and processes, the impact of the investigation work on potential tribunal claims, and managing staff exits. The "investigative" and "employment" parts of the process need to be delineated as confidentiality and privilege that apply to investigative interviews do not transfer to grievance and disciplinary processes. Labour laws vary tremendously across jurisdictions and employment law risk is always heightened in cross-border investigations; for example, France and Germany do not currently have one concise code/regulation in this area and, like other EU countries, will need to introduce new laws by December 2021 to comply with an EU Whistleblower Protection Directive – there will therefore be significant change as EU countries pass legislation and EU employers revise policies and procedures to comply with the new rules.

Specific considerations (under UK law) include:

- in order to be protected, the whistleblower only has to reasonably believe that their allegation of wrongdoing is true – it does not matter if the allegation is in fact untrue;
- a whistleblower is protected even if they raise their allegation in "bad faith" (e.g. for personal gain);
- whilst the whistleblower must reasonably believe their disclosure is in the public interest (in order to be protected), case law has shown this is a low hurdle;
- compliance with whistleblowing and grievance processes;
- the need for any suspensions or dismissals;
- communications with employees, both those who are whistleblowers or have brought claims, those whose assistance may be needed as witnesses or resource, and the wider body; and
- exit arrangements and settlements.

Interviews

Witness interviews are an important part of evidence gathering. We have already mentioned the challenges they present around privilege. Interviews have to be handled skilfully and cautiously.



There have been a number of high profile complaints from interviewees about the conduct of interviews, and the clarity of explanations around who interviewers work for. Interviews, particularly of sensitive issues, need to be conducted carefully and with appropriate explanations, warnings and caveats. In the present Covid environment, challenges may also arise over the veracity and confidentiality of interviews that have to be conducted remotely – including the risk of unauthorised recording and the presence of other parties.

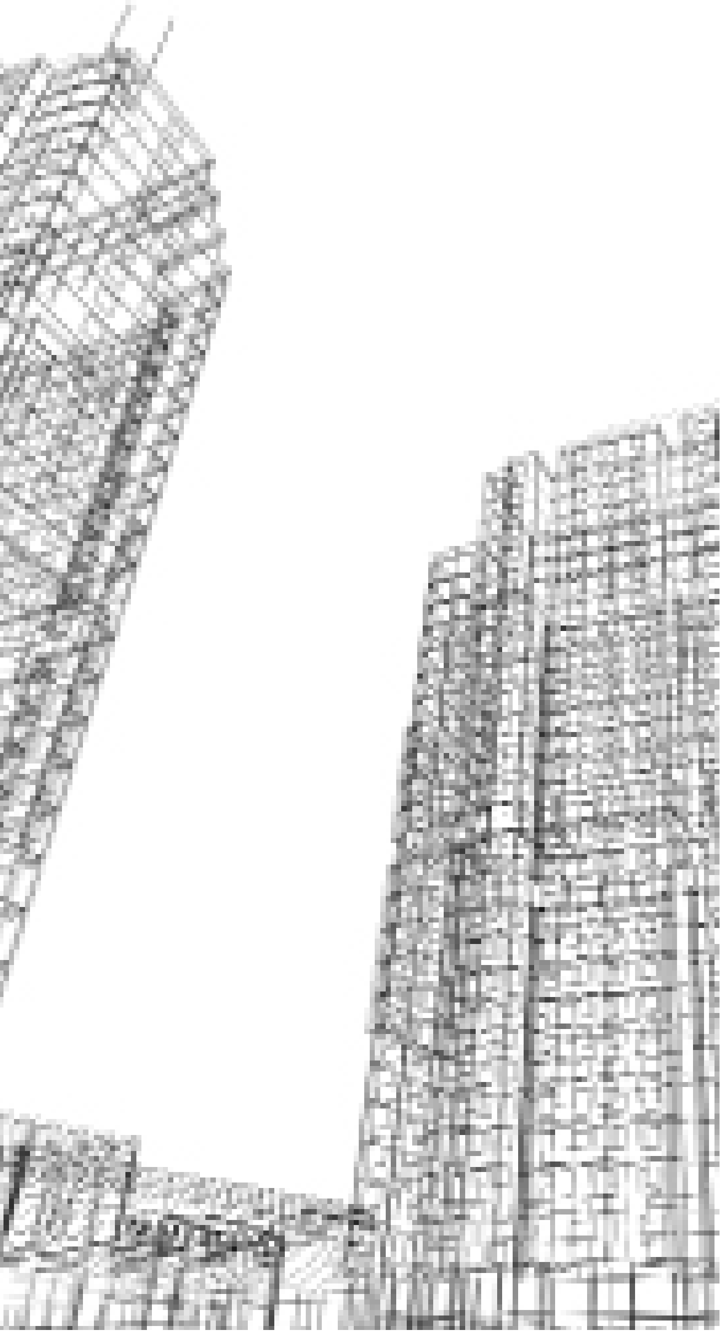
Communicate effectively with stakeholders

Part of the value of voluntary investigations and reviews is in the opportunity to explain and position the subject matter and findings with stakeholders. To optimise this opportunity, consider:

- The need for "Maxwellisation" in relation to certain types of investigations – a process of allowing individuals who are named in the report an opportunity to comment before publication. This is a way both to check the accuracy of findings and reduce defamation risk (if the report will be public or shared widely).
- The need for market announcements or shareholder communications, particularly if an issue, or the investigation itself, has been made public.
- What should be said (if anything) by way of key messages to the Board and to other internal stakeholders.
- Public relations support if the outcome is to be communicated more widely, or if there is press interest in the work.

Consider reporting obligations

Companies need to consider reporting obligations from the outset of an investigation and keep them under review. The UK has very expansive legislation relating to money laundering. Dealing with criminal property that a person knows or suspects is criminal property can itself be a money laundering offence. This is the case even where the crime has been committed by third parties not linked to the company. This means that, as the company's understanding of an issue develops, it may risk committing a criminal offence. A good example of this is where a portfolio company may be receiving contract revenues. Following an allegation and investigation, the company may develop a suspicion that the contract may be tainted. That state of



mind can transform the revenues into "criminal property" for money laundering purposes. In those circumstances companies will wish to secure a statutory defence to money laundering, which may be available through reporting the conduct in a prescribed way.

PRA and FCA regulated firms may have additional regulatory reporting obligations arising from the conduct under investigation. Listed firms may have to consider market announcement obligations.

In addition to statutory and regulatory reporting obligations, companies will need to consider whether the conduct triggers contractual reporting obligations such as under insurance policies, financing agreements and other commercial arrangements.

Get expert help

The discipline of conducting investigations is developing all the time. While there are a lot of black letter legal issues that arise, much of the wisdom and learning in relation to investigations is borne out of experience and embedded in good practice rather than hard law. The areas we have set out above are key issues where inexperience can trip companies up. Investigations are a fact of corporate life and play an increasingly important part in how companies can provide assurance around strong corporate governance. It is important to achieve best practice.

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WATERSHED MOMENT FOR DIRECTORS' LIABILITY

THE GOVERNMENT'S ARGA ACCOUNTING AND AUDIT WHITE PAPER

The government has long been looking at reforming regulation of accounting and audit against the backdrop of a recent spate of corporate accounting frauds and collapses. On 18 March 2021, it launched a White Paper on 'Restoring trust in audit and corporate governance' (the White Paper). Comment on the Proposals is open until 8 July and the FRC has been holding a number of outreach sessions for various constituencies to express their views.

A key feature of the Proposals as they affect corporates is the creation of regulatory liability for all large company directors (executive and non-executive). The liability will apply to a range of new obligations in relation to accounting and audit matters.

Currently, directors who are not chartered accountants are only regulated if they are held responsible for market abuse as in financial services (by the PRA or FCA) or are directors of listed companies subject to the market abuse regime. Directors can also, in extreme scenarios, be prosecuted for narrow criminal offences and under the Directors Disqualification Act, but these cases are rare.

The White Paper proposes that directors should be subject to investigation by ARGA and financial penalty or temporary disqualification. This is a major change to the corporate governance liability landscape for directors. PE firms will want to think carefully about these risks when placing directors on boards and identifying and valuing targets.

Which companies will be caught?

Companies which meet a proposed wider definition of 'Public Interest Entity' will be caught. There are two alternative proposals on extension of the definition to private companies, which currently captures mainly premium listed companies. There is also a proposal to include certain AIM listed companies:

	DESCRIPTION	ESTIMATED ADDITIONAL COMPANIES CAPTURED
Private company Definition option 1	More than 2,000 employees; or Turnover of more than £200 million and a balance sheet of more than £2 billion	1960
Private company Definition option 2	Over 500 employees; and Turnover of more than £500 million	1060
AIM companies	Market capitalisation exceeding €200 million	105

New director regulatory liability

The White Paper proposes codifying some or all of the existing directors' duties contained in the Companies Act 2006 into regulatory duties, insofar as they relate to accounting and audit matters. In addition, the White Paper proposes giving ARGA powers to create new conduct rules governing directors' behaviour in connection with accounting and audit matters. For example, they may include the obligation to act with due skill, care and diligence. The example given in the White Paper is a requirement to "act with honesty and integrity" – similar to the FCA's conduct rule obligation on individuals working in financial services.

New annual statement on internal controls and liability for inaccuracy

The White Paper recommends requiring directors to sign an annual statement on the adequacy of internal controls and procedures for financial reporting. This is modelled on the equivalent requirement in Sarbanes-Oxley, though breach of the rules would not result in criminal liability. The obligation would apply to directors collectively rather than to individual directors such as the CFO.

The White Paper suggests that, to be effective, the statement would need to include an explanation of how the directors have assured themselves that it is appropriate to make the statement, describe any deficiencies identified and set out what remedial action is being taken.

ARGA will have the power to investigate the accuracy of the annual statement and discipline directors for signing inaccurate statements – though against what test, or level of inaccuracy, is not clear. The work done to support the annual statement might itself flush out previously undetected issues, such as incidents of insider fraud.

Other new statements and obligations

The White Paper proposes that directors should be obliged to make the following further statements annually:

- **Dividends** – directors (possibly only of listed companies) will be required to publish a statement that a proposed dividend is in compliance with their legal obligations and will not threaten the solvency of the company over the next two years.
- **Resilience statement** – directors are to assess the company's prospects and challenges and make a descriptive statement about them.

- **Steps taken to prevent and detect material fraud** - The Government proposes to require directors to report on the steps they have taken to prevent and detect material fraud.

The White Paper does not make an explicit link between the adequacy of these statements and ARGA's powers of investigation and enforcement. We anticipate that where a statement is shown to be materially inaccurate, ARGA might seek to investigate directors for breach of the new proposed directors' duties in making the statement.

Obtaining privileged material shared with auditors

In pursuit of more effective enforcement powers against auditors, the Government has also asked for input on whether ARGA should be able to require auditors to hand over material shared with auditors by firms on a privileged basis during an audit. This power would represent a significant intrusion into corporates' entitlement to protect their privileged material and would undermine the current process by which auditors are able to gain comfort on live issues by reviewing privileged work being undertaken, for example internal investigations and ongoing litigation. In our view this proposal is not justified.

Malus and clawback provisions

Although the majority of FTSE 350 listed companies will have malus and clawback provisions in place already, outside of the financial services sector there are no mandatory requirements in this area. The Proposals seek to standardise these requirements by extending these provisions to all listed companies, potentially through changes to the UK Listing Rules. The Proposals seek to impose certain minimum "trigger points" and a minimum two-year period of application after an award is made. For many directors, these triggers will go beyond the arrangements currently in place.

Implementation

There is no set timetable yet for implementation, but the Government assumes ARGA will be created by April 2023. Transition periods or phasing may be used and the indications are that measures that directly impact companies which are not listed are likely to be introduced more slowly. For example, rules on the annual statement on internal controls will be imposed first on premium listed companies, with other PIEs being given a further two years to prepare.

Takeaways for Private Equity

The changes reflect a step change toward the "professionalisation" of the director role. PE should consider the additional risks to directors placed on boards and the training needed on these new requirements. Inevitably, there will be costs associated with preparing the proposed annual statements, at least initially, although hopefully these will be more proportionate than those associated with the introduction of Sarbanes-Oxley in the US. These costs should be factored into acquisition strategies, although in future the statements could assist in due diligence on targets. Director and Officer liability insurance, covering the costs of any investigation (though potentially not fines and penalties) should also be reviewed, noting that the D&O market is likely to continue to tighten given these new risks.

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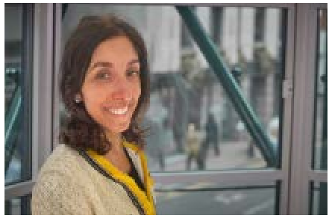

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PROBLEMS. POSSIBILITIES.
COMPLEXITY. CLARITY.
OBSTACLES. OPPORTUNITIES.
THE DIFFERENCE IS IMAGINATION.

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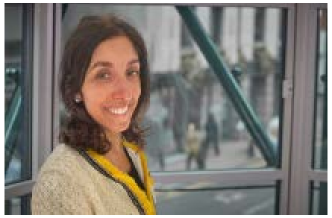

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