MAKING THE COMPANY PAY –

DEVELOPMENTS IN CORPORATE LIABILITY FOR ECONOMIC CRIMES

Richard Lissack QC[1]
Fountain Court Chambers

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A. OVERVIEW

1. This topic could not be more current:

   (a) on 13th January the government launched a consultation on options to extend corporate liability for crimes committed "*in its name*";

   (b) on 18th January the most significant Deferred Prosecution Agreement yet was approved by the Court thereby raising the profile of the SFO to stand alongside their US counterparts in making a large corporation bend to the criminal law;

   (c) on 20th January Mark Steward the Head of Enforcement at the FCA has just signalled a ramping up of hard edged action against companies in the regulated sector;

   (d) on 6th February the latest – and most far reaching – attempt by the Serious Fraud Office to get behind the veil of privilege invoked by a corporation under investigation, comes to trial.

2. The atmosphere around "*holding a company to account*" is febrile.

3. In this talk I will look at four points:

   (a) the present state of the law and the much criticised "*doctrine of identification*".

   (b) the options for change – no change is not currently a real world option.

[1] I am indebted to Nicolas Damnjanovic who is a pupil at Fountain Court Chambers for his research and assistance in producing this paper.

(c) Lastly, I will look at the context for the mooted substantive change and consider corporate liability through

(i) the prism of a DPA and

(ii) the vigorous assault by the SFO on legal professional privilege.

B. THE PRESENT ROUTE TO CORPORATE CRIMINAL LIABILITY

4. A corporation is a legal fiction. It is not capable of acting. Instead, the law imposes criminal liability on companies based on the acts of natural persons.

5. In some cases, the rules for criminal liability of companies are stated expressly in legislation. For example, s7 of the *Bribery Act 2010* holds companies strictly liable if bribery is committed by an 'associated person', unless the company can show it had adequate measures in place to prevent the misconduct from occurring. For other offences, the common-law rules apply.

6. The basic common law rule is the doctrine of identification. Under this doctrine, where an offence has a *mens rea* element, a corporation is only criminally liable for the acts of a person who was speaking or acting *as* the company. Traditionally, the courts have said the acts of a person are the acts of a company when the person is acting as the *directing mind and will* of the company.[2] That is, both the acts and mental states of those who are the directing mind and will of the company are attributed to the company.

7. In ***Tesco Supermarkets Ltd v Nattrass*** [1972] AC 153 it was made clear that the doctrine of identification applies to "the Board of Directors, the Managing Director and perhaps other superior officers who carry out functions of management and speak and act as the company".[3] A company's constitution will also give guidance as to which acts of which officers are acts of the company.[4] Further, a company may be liable for the acts of lower

[2] Viscount Haldane LC in ***Lennards Carrying Co Ltd v Asiatic Petroleum Co Ltd*** [1915] AC 705 at 713 and see also ***Bolton Engineering Co v Graham*** [1957] a QB 159 (per Denning LJ).
[3] At 171 per Lord Reid. See also 187F-H per Lord Morris, 191A per Lord Pearson, 199F per Lord Diplock.
[4] At 199F per Lord Diplock. See also ***Meridian Global Funds Management Asia Ltd v Securities Commission*** [1995] 2 AC 500, 507D-F.

level employees, but only where a superior officer has delegated specific functions to them with full discretion to act independently.[5]

8. Thus, the doctrine of identification, as explained in ***Tesco Supermarkets Ltd v Nattrass***, typically limits corporate liability to the board of directors or senior officers of the company. For that reason, some argue it provides perverse incentives for companies to decentralise their activities to avoid liability, and does not apply effectively to large companies.[6]

9. In ***Meridian Global Funds Management Asia Ltd v Securities Commission*** [1995] 2 AC 500 the Privy Council considered the issue of corporate liability in the context of a criminal breach of a regulatory regime. In his leading judgment, Lord Hoffman held that insistence on the directing mind and will test, as explained in ***Tesco v Nattrass***, may sometimes defeat the intention of the legislature in creating the offence. In such cases the court should interpret the statute to fashion a more appropriate rule of corporate liability. That is, while the directing mind and will test is a primary rule of attribution, for regulatory offences corporate liability may be extended through an application of the usual rules of statutory interpretation.

10. Subsequently, and apparently in conflict with ***Meridian Global***, the Court of Appeal has restated the primacy of the ***Tesco v Nattrass*** rule.[7] However, in ***Bilta v Nazir*** four members of the Supreme Court endorsed Lord Hoffman's contextual approach.[8] Whether the ***Meridian Global*** approach applies to economic crime, including fraud offences, remains untested.

[5] 171F per Lord Reid and 193A-B per Lord Pearson.
[6] For example, Pinto, A and Evans M *Corporate Criminal Liability*, 3rd edition, pp49-50. See also Gobert J "Corporate Criminal Liability: four models of fault, *Legal Studies* (1994) 14: 393, 401: "One of the prime ironies of *Nattrass* is that it propounds a theory of corporate liability which works best in cases where it is needed least and works least in cases where it is needed most"
[7] ***R v St Regis Paper Co Ltd*** [2012] 1 Cr. App. R. 14
[8] ***Bilta (UK) Ltd (in liquidation) and others v Nazir and others (No 2)*** [2015] UKSC 2, at [41] per Lord Mance, [67] per Lord Sumption, [190]-[195] per Lords Toulson and Hodge.

C. PROPOSALS FOR CHANGE

11. On 13 January 2017, the Ministry of Justice opened a call for evidence for a consultation on '*Corporate Liability for Economic Crime'*.[9] The purpose of the call for evidence is to assess whether there are problems with the doctrine of identification and to consider the case for reform in areas of economic crime other than bribery and tax evasion. The following 5 options for reform are being considered.

12. Option 1 – Legislative Amendment of the Doctrine of Identification: This option involves replacing the common-law rules for attributing acts and states of mind of natural persons to companies in the context of economic crime. As the Consultation Paper points out, retaining the doctrine of identification in any form may encourage companies to adopt internal structures that evade corporate liability rather than promoting the prevention of corporate crime.

13. Option 2 – Creating a Vicarious Liability Offence: This option involves the creation of a strict liability offence based on the familiar principles of vicarious liability. The commission of an economic crime by an employee, representative or agent would result in the company being guilty of the same substantive offence. This option could be supplemented with a due diligence defence to promote good governance. Given that vicarious liability is rare in crime, this is quite a radical suggestion.

14. Option 3 – Creating a Direct Liability Offence: This option involves the creation of a new strict liability offence such as a failure to ensure an economic crime was not committed in the company's name or on its behalf. Thus, the commission of an economic crime in the company's name or on its behalf would result in the company being guilty of a different, strict liability offence, again possibly subject to a due diligence defence. The model for this offence would be s7 of the *Bribery Act 2010*.

15. Option 4 – Creating a 'Negligent Failure to Ensure' Offence: This option involves the creation of a new direct liability offence like Option 3, but with an additional fault element. The fault element may be negligence or a failure to implement adequate systems

[9] https://consult.justice.gov.uk/digital-communications/corporate-liability-for-economic-crime/supporting_documents/corporateliabilityforeconomiccrimeconsultationdocument.pdf

for preventing economic crimes being committed in the company's name or on its behalf. Thus, rather than a due diligence defence, with the burden of proof on the accused, this option would place the burden on the prosecution to prove a failure of due diligence.

16. Option 5 – Regulatory Reform on a Sector by Sector Basis: This option involves strengthening individual accountability, particularly at senior management level, on a sector by sector basis. The goal is to deter misconduct. The model is the current regulation of the financial services industry. This option does not reform the rules for corporate liability, but seeks to prevent corporate crime using alternative measures.

17. The Ministry of Justice has expressed a clear preference for Option 3: namely, to introduce a new offence, or offences, on the model of s7 of the *Bribery Act 2010*. The 'clear advantages' to which the Ministry of Justice points are that such an offence:

    (a) is readily applicable to offending by large and small organisations;

    (b) is likely to incentivise companies to include the prevention of economic crime as an integral part of corporate governance; and

    (c) may enhance the effectiveness of Deferred Prosecution Agreements (see below) by creating a more realistic threat of prosecution.[10]

18. Should the case for Option 3 be made out, the Ministry of Justice would likely apply it first to a "*short list of the most common serious economic crime offences*", such as:

    (a) the common-law offence of conspiracy to defraud;

    (b) the offences at section 1 of the *Fraud Act 2006*;

    (c) the offence of false accounting at section 17 of the *Theft Act 1968*;

    (d) the money laundering offences at section 327 to 333 of the *Proceeds of Crime Act 2002*.[11]

[10] Ministry of Justice call for evidence 'Corporate Liability for Economic Crime' at p 21
[11] Ministry of Justice call for evidence 'Corporate Liability for Economic Crime' at p 22

The Government would also consider whether liability for such an offence, or offences, should accrue from secondary participation (including aiding and abetting) or inchoate conduct (such as statutory conspiracy, attempts and assisting and encouraging).

D. CONTEXT

Deferred Prosecution Agreements

19. Deferred Prosecution Agreements ("DPAs") were developed in the United States as a matter of practice; first in relation to individuals and subsequently in relation to corporations. DPAs were introduced in England and Wales by s45 and Schedule 17 of the *Crime and Courts Act 2013* ("CCA") on 24 February 2014. DPAs were seen as a cost-effective way to encourage self-reporting and thus a useful tool to reduce corporate crime in a time of austerity and reduced public expenditure. Moreover, while a DPA is meant as a punishment, it avoids the long, costly process of a complex investigation and prosecution.[12] Three DPAs have been concluded to date.[13]

20. As well as the CCA, the use of DPAs is governed by:

    (a) The Deferred Prosecution Agreements Code of Practice ("DPA Code");[14]

    (b) The Corporate Prosecution Guidance;[15]

    (c) The Bribery Act Guidance;[16] and

    (d) The Code for Crown Prosecutors ("Code")[17]

21. <u>When?</u> DPAs can only be used in relation to one of the offences listed in Part 2 of Schedule 7. The list covers a range of economic and financial offences, including conspiracy to defraud and certain offences under the *Theft Act 1968*, *Financial Services*

[12] See Sir Edward Garnier QC, Luke Tolaini and Chris Stott 'Deferred Prosecution Agreements', in Richard Lissack QC and Fiona Horlick (eds) *Lissack and Horlick on Bribery*, 2nd ed, 2014, ch 10.
[13] ***SFO v Standard Bank plc*** (U20150854), ***SFO v XYZ Ltd*** [U20150856] and ***SFO v Rolls Royce Plc*** U20170036
[14] https://www.cps.gov.uk/publications/directors_guidance/dpa_cop.pdf
[15] http://www.cps.gov.uk/legal/a_to_c/corporate_prosecutions/
[16] http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf
[17] https://www.cps.gov.uk/publications/docs/code_2013_accessible_english.pdf

and Markets Act 2000, *Proceeds of Crime Act 2002*, *Fraud Act 2006* and *Bribery Act 2010*, among others. Before prosecutors can begin DPA negotiations, they must satisfy themselves of two things:

(a) **The Evidential Stage**: either the full evidential stage of the Code[18] is satisfied, or there is at least a reasonable suspicion based upon some admissible evidence that the corporate organisation has committed the offence, and there are reasonable grounds for believing that a continued investigation would provide further admissible evidence within a reasonable period of time, so that all the evidence together would be capable of establishing a realistic prospect of conviction in accordance with the full evidential stage of the Code.[19]

(b) **The Public Interest Stage**: the public interest would be properly served by the prosecutor not prosecuting but instead entering into a DPA with the corporate organisation, in accordance with specified criteria.[20] In determining where the public interest lies, the factors prosecutors must considere include the seriousness of the offence, the culpability of the corporate organisation, any history of similar offending, whether the organisation has self-reported (and whether this was done within a reasonable time), the impact of prosecution and conviction on the organisation and others, the level of co-operation and whether any remedial action or any steps to improve compliance have been taken.[21]

22. How? If the prosecutor is satisfied that the evidential and public interest stages have been passed, it *may* offer the corporate organisation the opportunity to enter into DPA negotiations. There is no obligation on the corporate organisation to accept that offer. Either party may withdraw from negotiations at any time. If the negotiations are unsuccessful the prosecutor may prosecute.

23. If negotiations are successful, but before the DPA is agreed, the prosecutor must apply to the Crown Court for a declaration that entering into a DPA with the corporate organisation is likely to be in the interests of justice, and the proposed terms of the DPA

[18] That is, "Prosecutors must be satisfied that there is sufficient evidence to provide a realistic prospect of conviction against each suspect on each charge. They must consider what the defence case may be, and how it is likely to affect the prospects of conviction"
[19] 1.2(i) of the DPA Code
[20] 1.2(ii) of the DPA Code
[21] 2.5-2.10 of the DPA Code

are fair, reasonable and proportionate[22] ("Preliminary Approval"). If that declaration is made, the parties may agree the DPA and then the prosecutor must seek a further declaration in the same terms[23] ("Final Approval"), the granting of which will bring the agreement into force[24]. While the Preliminary Approval hearing is private, the Final Approval hearing is public. At the time Final Approval is given the prosecutor prefers the bill of indictment which is then automatically suspended.[25]

24. What? The CCA gives a non-exclusive list of possible terms of a DPA including payment of financial penalties, compensation, disgorgement of profits made from the alleged offence and compliance with measures to prevent future offending.[26] The DPA must also specify an expiry date, which is the date on which it ceases to have effect.[27]

25. Judicial Approval: In considering whether a DPA is in the interests of justice, courts will apply much the same considerations as are applied by prosecutors at the public interest stage described above.[28] In considering whether the terms of the DPA are fair, reasonable and proportionate, the courts will consider each term individually and the effect of all the terms as a whole. The amount of any financial penalty agreed between the parties must be 'broadly comparable' to the fine a court would have imposed had the corporate organisation entered a plea of guilty.[29] Courts will also consider the relevant sentencing guidelines in determining whether a financial penalty is appropriate.

26. Rolls Royce: the latest, and largest, DPA is ***SFO v Rolls Royce Plc*** U20170036, approved on 17 January 2017. Rolls Royce's alleged offending included offences relating to the bribery of foreign public officials, commercial bribery and the false accounting of payments to intermediaries. The conduct involved very senior managers and related to the procurement of contracts in several foreign countries that produced a combined gross profit of £250 million. The SFO investigation was *not* a result of self-reporting. While Sir Brian Levenson P acknowledged, the egregious criminality suggested, on its face, that the interests of justice required prosecution, he was swayed by the 'extraordinary'

[22] Para 7(1) of Schedule 17
[23] Para 8(1) of Schedule 17
[24] Para 8(3) of Schedule 17
[25] Paras 1(2) and 2(1) and (2) of Schedule 17
[26] Para 5(3) of Schedule 17
[27] Para 5(2) of Schedule 17
[28] See ***SFO v XYZ Ltd*** [U20150856] at [20]
[29] Para 5(4) of Schedule 17

co-operation of Rolls Royce in the SFO's investigation and the new policies, practices and cultures that had been implemented. The key terms of the DPA included disgorgement of profit of £258,170,000, a penalty of £239,082,645, SFO's costs of £12,960,754, co-operation in all matters relating to the relevant conduct and completion of a compliance programme.

27. Consequences of Breach: While a DPA is in force, if the prosecutor believes it has been breached, the prosecutor should first ask the organisation to rectify the breach.[30] If the request is not successful, the prosecutor can apply to the court seeking a variation of the DPA[31] or a finding that the DPA has been breached.[32] Where such a finding is made, the court may invite the prosecutor and the organisation to agree proposals to remedy the breach, or terminate the DPA.[33] The result of a termination is that the organisation loses any sums paid under the DPA and the prosecution may continue the prosecution.[34]

The Attack on Legal Professional Privilege

28. Legal professional privilege is a fundamental, substantive right. The privilege is absolute. It is not balanced against other public interests, including the interest in securing relevant and admissible evidence.[35]

29. Nevertheless, in recent times the SFO has made two complaints about the extent to which corporations can, and do, assert legal professional privilege over relevant material:

    (a) The assertion of legal professional privilege makes it more difficult to obtain the relevant information necessary to successfully prosecute corporations; and

    (b) Some corporations are "*ploughing up the crime scene"*[36] and then hiding behind the shield of legal professional privilege. That is, corporations conduct their own internal investigations into potential misconduct, including interviewing potential witnesses, in advance of SFO involvement and then assert legal professional privilege over the witness statements and other materials that are produced. As a

[30] 12.1 of the DPA Code
[31] Para 10 of Schedule 17
[32] Para 9(1) of Schedule 17
[33] Para 9(3) of Schedule 17
[34] 12.5 and 12.6 of the DPA Code
[35] *R v Derby Magistrates' Court, ex p B* [1996] AC 487.
[36] David Green CB QC as reported in The Times, 5 February 2015 'SFO chief takes on company lawyers'.

result, the SFO has no access to the 'unpolluted' witnesses or their original evidence.[37]

30. The SFO encourages corporations under investigation to waive privilege over materials which reveal the relevant 'factual narrative'. Of course, corporate organisations cannot be compelled to waive legal professional privilege over documents that the SFO may request.[38] However, the SFO has placed pressure on organisations by making it clear that a failure to supply relevant information will be seen as a failure to co-operate, which in turn is a strong factor against negotiating a DPA. This is formally stated in 2.9.1 of the DPA Code. It has also been the subject of public comment by senior SFO officers.[39]

31. This places organisations in a difficult position. If privilege is waived, but a DPA is not agreed or approved by the court, a prosecution may be commenced. In these circumstances the SFO may use the disclosed documents in a subsequent prosecution, with the exception only of those documents showing that the organisation entered into negotiations for a DPA or which were created solely for the purpose of preparing a DPA and the statement of facts.[40]

32. The SFO has also recently taken a more aggressive approach to challenging assertions of legal professional privilege. For example, the SFO has brought two very significant applications in each of two current high profile investigations (whilst the first application was compromised on confidential terms, the second comes to trial on 6th February):

    (a) As to the first, the SFO issued a warrant to compel a Bank to deliver up materials demanded of it under a Section 2 notice. They effectively sought an order that the bank release information which it said was *prima facie* subject to legal professional privilege, on the basis that it fell within the iniquity exception. That exception applies to communications made in furtherance of a crime or fraud, where at its

[37] "We just want accurate and complete first accounts of witnesses, and we do not understand why a truly cooperative company would deny us them. It is unhelpful of your clients to put their interest in civil proceedings ahead of assisting our criminal investigation." Alun Milford, SFO General Counsel 'Corporate Liability and Deferred Prosecution Agreements' delivered to the Employed Bar Annual Conference on 26 March 2014: https://www.sfo.gov.uk/2014/03/26/corporate-criminal-liability-deferred-prosecution-agreements/

[38] 3.3 of the DPA Code states: "The Act does not, and this DPA Code cannot, alter the law on legal professional privilege.

[39] "The assertion of privilege over witness first accounts is unhelpful and, frankly, impossible to reconcile with an assertion of a willingness to co-operate" Alun Milford, SFO General Counsel 'Corporate Liability and Deferred Prosecution Agreements' delivered to the Employed Bar Annual Conference on 26 March 2014: https://www.sfo.gov.uk/2014/03/26/corporate-criminal-liability-deferred-prosecution-agreements/

[40] See para 13(3)-(6) and 4.4-4.6 of the DPA Code.

most broad that caught '*fraud in this connection is not limited to the tort of deceit and includes all forms of fraud and dishonesty such as fraudulent breach of trust, fraudulent conspiracy, trickery and sham contrivances*'.[41] As I say, that application was never adjudicated on because it was compromised without need for a full hearing (listed before Cooke J).

(b) As to the second, in an effort to avoid some of the procedural difficulties evident in the claim against the Bank mentioned above, the SFO has brought a claim under Part 8 of the CPR against ENRC for declarations that material generated by a corporation and its advisors during a (claimed) self-reporting process are not and never were subject to legal professional privilege. ENRC and its former lawyers had generated material between 2011-2013 in communication with the SFO who now seek permission to use that material, including the fruits of the investigations carried out by and on behalf of ENRC and shared with the SFO, in their criminal investigation of ENRC, its affiliates and certain individuals, on the grounds that such material never was subject to legal professional privilege. (The trial will be heard before Andrews J).

E. CONCLUSION

33. Undoubtedly, the next phase of this century will be marked by a significant shift in the law's efforts to hold companies to account when crime that may properly be labelled "*corporate*" has been committed.

34. Opinion on this will be sharply divided: whether you consider the boardroom is no place for the policeman, and making shareholders and workers' pay the price for decisions made and things done far from their gaze, or, whether you think the law is the law, fraud is fraud, and no one – and no company – is beyond its reach, and that change is long overdue as the law has failed to keep pace with the real world of business, the likelihood is that you will agree on one thing: as Bob Dylan wrote *"….the times they are a-changin'…."* and corporations had better (to paraphrase) "….*start swimming of they'll sink like a stone….because the battle outside is raging and it'll soon shake their windows and rattle their walls".*

[41] ***Crescent Farm (Sidcup) Sports Ltd v Sterling Offices Ltd*** [1972] Ch 553 at 565.