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Rt. Hon Nicky Morgan MP
Chair of the Treasury Select Committee
House of Commons
London
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Our Ref: PO-558

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Dear Ms Morgan,

During the recent oral evidence session I attended on 4th July, I promised to provide the Committee with a note outlining the SFO's views on the law surrounding corporate criminal liability and the benefits of an extension of the failure to prevent offence to other economic crimes.

The attached note contains a summary of the key information as well as our proposals for amending the law.

I hope this information is of assistance to you and the other members of the Committee.

Yours sincerely

Mark Thompson

MARK THOMPSON
DIRECTOR

<u>Note on Corporate Criminal Liability</u>

<u>Background</u>

It is well established that a company has legal personality that is distinct from its shareholders, directors and officers, and that there are legal mechanisms by which a company can be prosecuted for a crime.

Some offences specifically set out how a company may be criminally liable. For example, the Bribery Act 2010 sets out at section 7 the circumstances under which a company will be liable for failing to prevent bribery. However, for the vast majority of offences, there is no express provision for prosecuting companies.

In respect of crimes which require proof of a mental element (such as dishonesty or recklessness), the attribution of corporate criminal liability is governed by the common law doctrine of identification or the Identification Principle.

Under the Identification Principle, a company can be fixed with criminal liability by establishing that a person who was the "directing mind and will" of the company at the relevant time carried out the acts and had the necessary mental state.

The concepts behind the Identification Principle have been developed by the courts in a number of cases. However, there remains uncertainty as to who represents the directing mind and will of a company. It has generally been accepted that directors and senior officers of the company are likely to be capable of being directing minds in most cases. However, in large, multi-national companies, the day to day management of the business will typically be delegated to managers or subsidiary companies and there is currently a lack of clarity as to what level, and under what circumstances, the directing mind and will of the company can be fixed.

As a result, it is often impossible to prosecute the company, notwithstanding the fact that they may be the main beneficiary of the wrong doing.

Summary of Issues with the Identification Principle

<u>It leaves the beneficiary unpunished</u>

Where it is impossible to establish corporate criminal liability (for reasons given below), it may only be possible to prosecute individuals. This means that a commercial organisation, which is often the primary beneficiary of the conduct in question, escapes criminal sanction. Those businesses, irrespective of their size, should be held to account for that damage, just like everyone else in society.

<u>Uncertainty of scope</u>

The scope of the identification doctrine is unclear. Even within the leading case of *Tesco v Nattrass* [1972] A.C. 15, the Law Lords each gave their own differing versions of how to attribute corporate criminal liability. They varied in the relative importance they gave to formal positions and practical control.

Whilst is it is generally recognised that directors and senior officers of a company will represent the directing will and mind, the position of other crucial roles remains ambiguous. In large corporations, mid-level managers, such as regional heads or senior members of finance teams, can play critical roles in corporate wrongdoing, yet they are unlikely to be regarded as representing the directing minds and will of the company.

This uncertainty makes it harder to hold companies to account. It also puts UK agencies at a disadvantage internationally with other law enforcement agencies who are able to apply stronger laws with greater extra-territorial scope. The US model of vicarious liability and their jurisdiction where US dollar transactions are involved allows them to hold UK corporates to account and levy large fines where UK agencies cannot.

Unfair in its application

The identification doctrine leads to the inequitable position that it is far easier to fix small, owner-managed companies with the requisite knowledge and intent than international complex companies. The practical reality is that in a multi-national company, the few people who could embody the "directing will and mind" of the company will not necessarily involve themselves in the company's operations in the same way as a director of a smaller, family-run enterprise.

Therefore and perversely, larger companies, which have the opportunity to create greater harm, are less likely to be found criminally liable for acts committed on their behalf. A key example of this is the *Libor* case where it was impossible to bring charges against the banks as the corporate structures involved were too large and complex to apply the identification doctrine with confidence.

Counterproductive in policy terms

Liability is predicated on the knowledge of the few people who could be said to embody the controlling mind of the company. This position encourages those leaders to distance themselves from the operation of the company. The law actively incentivises bad behaviours such as:

- devolution of decision making;
- a "don't raise that with me" attitude;
- a lack of record keeping;
- important documents spread over a number of entities and jurisdictions; and
- an arm's length approach to the risks of crime taking place within the organisation.

Undermines the Deferred Prosecution Agreement ("DPA") regime

The current restricted nature of the identification doctrine substantially undermines the DPA regime. Whilst there are significant advantages of the DPA regime for a company, corporate offenders may need to be convinced that they would face a serious risk of being found guilty of a relevant offence before they agree to enter into negotiations

Why Regulation is not the answer

Regulation has an important part to play, but it does not meet the challenge. Regulation only covers a limited section of corporate activity and cannot affect non-regulated sectors and the SFO has several investigations underway into non-regulated businesses that illustrate this point. Regulation also tends to focus on procedures and record keeping rather than on the end goals of preventing and punishing offending. In addition, a regulatory sanction does not carry the weight or impact of a criminal conviction or the terms of a DPA.

The SFO's Proposals

The SFO proposes two equally favoured and parallel options:

1. **Replacing the identification doctrine with a new principle for the attribution of corporate liability**. This would set out the circumstances in which a company would be liable for the substantive criminal offence.

   The SFO's proposal is that a company would be guilty of the substantive offence if a person associated with it commits that offence intending:

   - To obtain or retain business for the company;
   - To obtain or retain a business advantage for the company; or
   - Otherwise to (financially) benefit the company.

   This solution would provide a principled basis on which all companies would be liable for all substantive offences.

2. **The introduction of a new offence of failing to prevent economic crime**. This solution aligns well to the provisions of section 7 Bribery Act 2010, as well as the new Criminal Finances Act offence of failure to prevent tax evasion, and promotes consistency across the wider economic crime landscape. Section 7 of the Bribery Act has been proven to be effective in its application. This would allow for a quicker and consistent solution to this urgent problem.

   The Rolls-Royce case is an important example of the S.7 offence being used (in part) to establish corporate liability. Other SFO cases where s7 has already been used successfully include the DPAs entered into with **Standard Bank** and **XYZ Ltd** together with the conviction of **Sweett Group plc**. It is becoming the focus of more investigations carried out by the SFO illustrating that it is an important tool in the fight against bribery.