



# The criminalisation of corporate conduct

ARE CORPORATES AND FINANCIAL INSTITUTIONS FACING INCREASED RISK OF CRIMINAL LIABILITY?

The UK appears likely to continue its shift towards adopting some of the prosecutorial techniques employed in the US, while contemplating legislative reform to facilitate easier corporate convictions. In the light of the current environment, recent corporate scandals and the attendant shift in enforcement priorities, there is little doubt that corporates and financial institutions should anticipate an increased risk of criminal prosecution by both domestic and foreign authorities.

## Introduction: calls for reform of the UK prosecutorial approach

The UK's Financial Services Authority (FSA) and Serious Fraud Office (SFO) have come under fire in recent years for their patchy records in securing criminal convictions, especially when compared with their counterpart authorities in the US. One of the more recent and comprehensive criticisms came in June 2008 in the form of a report by Jessica de Grazia, a former assistant district attorney in Manhattan, on the prosecution of cases by the SFO. The report was highly critical of the SFO's conviction rates, lack of investigative focus and inefficient use of resources. It brought the differences in approach between prosecutorial authorities in the UK and the US into stark contrast by highlighting the handling of the Allied Deals criminal conspiracy case. Despite similar fact patterns on both sides of the Atlantic, the SFO's team of 31 staff secured just three convictions, while the US Attorney's Office for the Southern District of New York secured 14 convictions using a team of just eight staff – and in a third of the time.

Responses to De Grazia's report have been mixed, but senior officials from both the SFO and the FSA have embraced the need for prosecutorial reform in the UK and have been vocal in their support for the adoption of some prosecutorial techniques used by their counterparts in the US. When set against the backdrop of the current enforcement environment shaped by the global financial crisis and recent corporate frauds and scandals, an increased appetite for criminal enforcement on the part of authorities and increased resourcing of prosecutorial agencies to feed that appetite, together with reform of substantive law on corporate

criminal liability in the UK, corporations and financial institutions face an unprecedented, and increasing, risk of criminal prosecution.

## US prosecutorial techniques: coming soon to a regulator near you?

The US Department of Justice (DOJ) is the principal instigator of corporate prosecutions in the US. The cornerstone of its approach to prosecution of corporations is its Principles of Federal Prosecution of Business Organizations,<sup>1</sup> which specifies the factors that prosecutors must consider before deciding whether to charge a corporation. One factor that UK authorities appear keen to explore further is the credit to be given for voluntary disclosure and co-operation with the investigation. This has proved a controversial issue in the US in recent years due to concerns that prosecutors have overstepped the mark by exerting undue pressure on companies to grant privilege waivers in order to secure co-operation credit. Similar strong-arm prosecutorial practices aimed at discouraging companies from providing counsel or advancing legal fees to its own company executives and employees have also come under fire, with US courts having found the practice in one case to have violated the constitutional right to counsel.<sup>2</sup>

<sup>1</sup> The current iteration of the Principles is otherwise known as the 'Filip Memorandum' (named after the deputy attorney-general responsible for its issue, Mark Filip); it can be found at Chapter 9-28 of the DOJ's US Attorney's Manual.

<sup>2</sup> The DOJ, in an effort to address these criticisms and to head off potential legislative intervention, has twice revised its prosecutorial guidelines in recent years, significantly scaling back prosecutors' ability to seek privilege waivers and providing that prosecutors should not, in assessing co-operation, take account of a company's decision to provide counsel or advance legal fees to company executives or employees.

Another prosecutorial practice under consideration by the UK authorities is the use of non-prosecution agreements (NPAs) and deferred prosecution agreements (DPAs). Under these, prosecutors agree not to file criminal charges (in the case of an NPA) or to file charges but defer prosecution for a period of time after which the charges are dropped (in the case of a DPA), provided in either case that the defendant complies with the terms of the agreement. Although NPAs and DPAs do not technically lead to a criminal conviction, prosecutors are nevertheless able to achieve their aims of deterrence, punishment and rehabilitation because the resolution of a criminal corporate investigation by means of a DPA or NPA will probably be accompanied by significant publicity and the terms of the agreement will often require payment of financial penalties, imposition of remedial measures and/or the appointment of a compliance monitor. Thus, although a company may avoid conviction, the requirements of an NPA or DPA can nevertheless be very burdensome in practical terms. NPAs and DPAs can be distinguished from another common prosecutorial practice, plea-bargaining, in which a guilty plea is entered and a conviction recorded.

The US experience demonstrates that criminal convictions are not necessary to achieve deterrence, punishment and rehabilitation – merely the threat of criminal prosecution is usually sufficient to shape corporate conduct. Moreover, the US experience has shown that a corporate indictment is not always desirable given its collateral effects on shareholders, employees and members of the public, especially if the company fails as a result.

Senior officials at both the FSA and the SFO have been vocal in their support of adopting some of the US prosecutorial tactics discussed above. For example, Richard Alderman, director of the SFO, has repeatedly indicated that he would like the SFO to consider the introduction of US-style NPAs and DPAs and has expressed interest in the development of a plea-bargaining system.

Some of these initiatives are already being introduced (although not necessarily in the same form as in the US). In March 2009, the attorney-general introduced a framework for plea negotiations in fraud cases, but was keen to distinguish the UK model from US-style plea-bargaining, noting that the UK framework was not concerned with offering discounts, immunity or incentives to fraudsters; nor does it require a defendant

to assist the prosecution. The focus of the guidelines, according to the attorney-general, is the encouragement of plea discussions at an early stage – before the charge – and in a more formal, open and transparent manner. However, the Coroners and Justice Bill currently making its way through the legislative process does propose giving the FSA the power to offer statutory immunity to co-operating witnesses (to supplement the FSA's existing common law power to undertake not to prosecute).

The SFO has already begun to experiment with measures similar to NPAs and DPAs in its recent settlement with Balfour Beatty, after the company self-reported inaccurate accounting records arising from certain payment irregularities in a subsidiary. Although the conduct in that case did not rise to a level supportive of criminal charges, the company agreed to the terms of a consent order filed in the High Court bearing many of the hallmarks of a DPA or NPA, under which it paid a financial settlement and a contribution towards the costs of the civil recovery order proceedings, and agreed to a package of compliance reforms and external monitoring.

Critics assert that the US prosecutorial toolkit affords prosecutors too much latitude, with the result that defendants' fundamental rights risk being infringed. The extent to which the UK will ultimately adopt some of the more controversial US prosecutorial techniques, and how these may work in practice, remains to be seen. However, it is anticipated that UK authorities will be shifting towards greater use of some of the more novel techniques borrowed from the US at the early stages of criminal prosecutions in an effort to secure easy wins with the expenditure of a minimum of resources.

### **Legislative reform of corporate criminality in the UK**

Historically, securing convictions of corporate defendants for serious criminal offences in the UK has been very difficult. This is mainly due to the requirement to show that the company's 'directing mind and will' (usually the board or similarly senior executives) has satisfied the fault requirement for the relevant offence, when the reality is that the conduct in question (eg the payment of a bribe) is often carried out by a staff member well below board level. By contrast, the threshold for corporate criminal liability in the US is very low. Under US law, a corporation can be found criminally liable for the acts of even a junior employee provided that the acts in question were within the scope of the employee's

authority and were carried out – at least in part – for the benefit of the corporation. This low threshold vests an enormous amount of discretion in the hands of prosecutors and goes some way towards explaining the comparatively high numbers of corporate convictions secured by US prosecutors.

But there are signs that reform of the UK corporate criminal liability regime is coming. The Corporate Manslaughter and Corporate Homicide Act 2007 introduced a new corporate homicide offence for which a company can be found guilty even if its ‘directing mind and will’ was not responsible (although senior management must still be substantially involved for guilt to be imputed to the company). Moreover, the Bribery Bill, currently making its way through the legislative process, proposes a new corporate criminal offence of negligently failing to prevent bribery. The Law Commission’s November 2008 report on reform of bribery law makes it clear that the draft legislation is intended to impose a lower threshold than the ‘directing mind and will’ test, making it easier to secure criminal convictions of companies that perpetuate a bribery-tolerant culture by failing to maintain appropriate safeguards and controls. Significantly, in response to concerns that the prevailing common law has made corporate prosecutions too difficult, the Law Commission is also carrying out a more general review of the basis for corporate criminal liability in the UK, which is likely to lead to further, more wide-ranging, reform.

### **Increasing emphasis on, and resourcing of, criminal prosecutions**

The UK authorities have sent out clear messages that criminal investigations will increasingly be used to ensure compliance. Margaret Cole, director of enforcement at the FSA, has emphasised the desire to see a shift in attitudes and said, ‘if people have to go to prison for us to achieve that aim then that’s what we are prepared to do’. Underlying such proclamations is the theory that high-impact criminal investigations and prison sentences for company employees will focus the minds of the senior executives responsible for shaping corporate culture. This approach is understandable, given the historic difficulties associated with prosecuting the company itself.

Recent high-profile appointments have served to re-iterate this strategy of deterrence, as well as injecting

some valuable levels of experience and expertise. In January 2009, the SFO appointed Vivian Robinson QC, a leading criminal barrister and fraud specialist, as its general counsel, and in March, David Kirk, director of the Fraud Prosecution Service, was appointed the FSA’s chief criminal counsel. In addition to hires at the top level, the FSA is in the process of expanding the staff of its enforcement division and the SFO has recently increased its number of anti-corruption staff. Moreover, it is likely that the SFO and FSA will receive increasing support from the City of London Police in the form of the specialist Overseas Anti-Corruption Unit following the announcement of increased funding for the specialist unit.

Across the Atlantic, the Federal Bureau of Investigation (which is responsible for investigating many cases that are subsequently prosecuted by the DOJ), has signalled a significant diversion of its investigative resources to the areas of mortgage fraud and corporate fraud and is fast-tracking many of those investigations. Unsurprisingly, a key current focus of US authorities is those responsible for – and those seeking to benefit from – recent events on Wall Street, with the DOJ as well as the New York Attorney General investing substantial investigative resources in this area.

The combination of prominent targets for investigation and increased resourcing suggests that companies and financial institutions should expect and prepare for an increase in the volume and profile of criminal investigations.

### **Extraterritorial enforcement of US criminal laws and economic sanctions**

In the modern enforcement environment, corporations and financial institutions – no matter in which jurisdiction they are based – need to be alive to the risk of criminal prosecution not only by domestic authorities, but also by foreign authorities exercising extraterritorial jurisdiction. The fact that a corporation or financial institution is the subject of criminal prosecution in its home jurisdiction does not bar foreign authorities from launching their own investigations of the same underlying conduct, and increased communication and co-operation between authorities on a domestic and an international level means that the threat of multiple investigations is increasing. In recent years, the DOJ has

adopted a series of novel and expansive interpretations of its own jurisdictional authority to impose criminal sanctions on corporations and financial institutions worldwide where the connection to the US has, at times, been tenuous. Often, the DOJ's investigation has followed on the heels of an investigation initiated by a foreign prosecutorial authority.

Recent activity suggests that the US Foreign Corrupt Practices Act (FCPA) remains an enforcement focus for the DOJ. The current FCPA enforcement environment is notable for its increased emphasis on extraterritorial enforcement, as well as the imposition of unprecedented fines. The DOJ's settlement of criminal FCPA charges against Norwegian company Statoil in October 2006 marked the first occasion on which the DOJ has taken major criminal enforcement action against a non-US issuer for conduct that took place predominantly outside the US. Moreover, the plea deal struck between DOJ prosecutors and Siemens in December 2008, which required Siemens to pay \$450m to the DOJ (in addition to large settlements with the US Securities and Exchange Commission and with German prosecutors), is the largest FCPA criminal fine imposed to date. Although UK authorities have been less vigorous than their US counterparts in enforcing anti-bribery legislation, in September 2008 the Overseas Anti-Corruption Unit of the City of London Police achieved the first foreign bribery conviction in UK history after an employee of security company CBRN and a Ugandan official pleaded guilty to bribery charges relating to a security contract in Uganda.

Extraterritorial corporate prosecutions for violations of US economic sanctions remain in the spotlight. Lloyds TSB recently agreed to pay a \$350m criminal forfeiture to the DOJ and the New York County District Attorney's Office in respect of economic sanctions violations. The asserted basis for jurisdiction was that Lloyds TSB had indirectly caused the export of financial services to Iran by causing its correspondent banks in the US to (unwittingly) process US-dollar funds transfers for Iranian and Sudanese persons. US authorities have indicated that similar investigations of a number of other non-US banks are continuing.

In the antitrust field, the DOJ imposed a record \$686m in criminal fines during the fiscal year 2008, many of which were against international companies as part of the DOJ's air cargo investigation. The Obama administration

has already signalled its intention to continue vigorous enforcement in this field. The imposition of criminal penalties for antitrust offences is still a relatively new concept in the UK, but in 2008 the Office of Fair Trading (OFT) secured its first convictions of corporate executives under the Enterprise Act 2002, resulting in prison terms for three UK nationals involved in the marine hose cartel. The OFT is pursuing criminal convictions under the Enterprise Act against British Airways executives.

### **An unprecedented, and increasing, risk of corporate criminal prosecution**

The reform and proposals for reform of UK substantive and procedural criminal law discussed in this briefing demonstrate a change in course by authorities and the legislature towards a more prosecutor-friendly environment in which the traditional threshold for securing a corporate criminal conviction is gradually lowering. When viewed through the prism of the current global financial crisis and recent corporate frauds, and the attendant change in focus of enforcement priorities by authorities (and their appetite for enforcement generally), this confluence of factors means that corporations and financial institutions face an unprecedented risk of criminal prosecution. The reality of the current enforcement environment is that corporations and financial institutions must be prepared to deal with multiple threats of prosecution on multiple fronts and from multiple authorities. If, as is expected, UK authorities borrow further from the prosecutorial practices of their US counterparts, and reform of substantive criminal law relating to corporations continues, it is likely that we will see a significant increase in corporate criminal prosecutions.

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