Fountain Court

Quarterly Commercial Crime Newsletter:

COMMENTARY

A look at the Law Commission's Options Paper on Reforming the Law of Corporate Criminal Liability

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AUTHORS

Nicholas Medcroft QC
Silk Date: 2019
Read more

Leonora Sagan
Call Date: 2012
Read more

Introduction

On 10 June 2022, the Law Commission published its long-awaited Options Paper on Reforming Corporate Criminal Liability (the "**Paper**"). The Paper follows the launch of the Commission's discussion paper in June 2021 and sets out ten options for reform (the "**Options**"). In this article, we discuss some key highlights from the Paper. While a discussion of all ten Options is beyond the scope of this commentary, they are all summarised at the end of this note.

Background

The 'identification doctrine' is the current model for attributing the criminal acts of individuals to a corporation under the law of England and Wales: it deems that only the actions and mental states of individuals who constitute the "*directing mind and will*" of a company can be attributed to the corporation.[1] The doctrine has been heavily criticised for failing to capture the reality of corporate decision-making and making it difficult to prosecute corporate fraud. The Paper seeks to respond to those concerns.

[1] *Tesco v Natrass* [1971] 1 AC 153.

The Purpose of the Paper

While the Paper does not make recommendations, it offers several options for reform and rules others out. In doing so it gives good insights into the Commission's thinking on the following five topics:

1. The doctrine of identification;
2. Failure to prevent offences;
3. Directors' individual liability under "consent or connivance" provisions;
4. Sentencing corporations; and
5. Administrative & civil law measures to address corporate criminal offending.

We discuss topics (1) (2) and (5) as the candidates most relevant to solving the problems with the identification doctrine.

What is meant by "economic crime"?

The Commission's definition of "economic crime" embraces a broad category of activity focussed on business: it includes market offences and the functioning of the financial system, a range of economic or unlawful business activity related to crime, as well as money laundering and fraud.[2] It does not, however, cover all acquisitive crime, nor all offences capable of being committed in a business context that are aimed at generating a financial benefit.[3]

(1) The Doctrine of Identification

The Paper's discussion of the doctrine of identification begins by setting out of that approach and in particular, the concern that it has been narrowed in a way which fails to reflect the reality of decision-making in complex organisations, making it too onerous to convict corporations for offences committed to their benefit.[4]

One criticism which is particularly troubling from a public policy perspective is that (at least on one view of *R v Barclays*[5]), the identification doctrine appears to reward companies whose boards do not pay close attention rather than creating incentives to ensure compliance:[6]

> *The issue … is that companies with poor oversight and compliance will not have the knowledge of misconduct at a sufficiently high level for the corporation to be fixed with it for the purpose of establishing intent, dishonesty, etc, whereas companies which do obtain such knowledge risk being criminally implicated.*[7]

The Paper provides three options for attribution in respect of offences with a fault element (other than negligence):[8]

- **Option 1 – Retaining the existing identification doctrine outlined in *Tesco v Natrass* [1972] AC 153.**[9] While canvassed as an option, maintaining the *status quo* is scarcely consistent with the Commission's unequivocal statement that *"the identification doctrine is an obstacle to holding large companies criminally responsible for offences committed in their interests by their employees."*[10] This Option is therefore appropriately caveated by the statement that, in the absence of reform of the doctrine itself, additional measures to tackle economic crime offences, such as 'failure to prevent' offences, will likely be

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[2] Paper, §1.15.
[3] The example given is that of a licensee who sells alcohol unwittingly to a seventeen-year-old.
[4] Paper, §3.58. The Paper notes that construction of the identification principle advanced in *R v Barclays* [2018] 5 WLUK 736 *"was felt, by many stakeholders, to have reduced the number of cases where the state of mind of individuals may be attributed to a corporation"*.
[5] [2018] 5 WLUK 736; upheld by Davis LJ in *SFO v Barclays PLC & Anor* [2018] EWHC 3055 (QB).
[6] See, by contrast, the emphasis in the government's guidance to the "adequate procedures" defence to s.7 Bribery Act 2010 offences, which focuses on the importance of instilling a culture of compliance through "top-level commitment" (Principle 2): *"Those at the top of the organisation are in the best position to foster a culture…in which bribery is never acceptable."*
[7] Paper, §3.84.
[8] Paper, §1.39.
[9] See Paper, §3.3 et seq. for a discussion of this authority.
[10] Paper, §3.91.

needed. The Paper notes that even such additions would not go far enough in addressing the gaps in enforcement caused by the doctrine.

- **<u>Option 2A</u> – Allowing conduct to be attributed to a corporation if performed by, or with the consent or connivance of, a member of its senior management.** A member of senior management would be any person who plays a significant role in the making of decisions about how the whole or a substantial part of the organisation's activities are to be managed or organised, or the actual managing or organising of a substantial part of those activities.[11]

- **<u>Option 2B</u> – As with Option 2A, but "senior manager" to include the chief executive officer and chief financial officer of the organisation.**

The Law Commission thereby rejected (a) the possibility of adopting a principle of *respondeat superior*;[12] and (b) models of attribution based on "corporate culture".

Corporate culture models of attribution operate not by identifying the acts of an individual and then ascribing them to the corporate, but rather by identifying the corporate equivalents of 'mind and will', such as corporate culture, formal company policies, and broader practices.[13] The question then becomes whether those permitted or licensed the unlawful conduct at issue.

The majority of consultees did not support this model, among them the SFO, which highlighted the lack of prosecutions under the equivalent Australian statute. Many also noted that "*corporate culture*" is a nebulous concept which is likely to be difficult to demonstrate in practice. It is also difficult to see how corporate culture models of attribution can accommodate dishonesty-based corporate offences (as opposed to mere negligence or intent).

(2) Failure to Prevent Offences

The Paper recommends the option of an offence of "*failure to prevent fraud*", limited to a small number of core fraud offences so as to avoid overlap and therefore confusion with existing liability regimes.[14] In doing so, it rejects a proposal for a broader offence of "*failure to prevent economic crime*" which will have come as a disappointment to many who favoured that approach.

The offence of failing to prevent fraud would be committed where:
- An associated person, P;
- Commits an offence of fraud;
- With intent to benefit the corporation; or
- With intent to benefit a person to whom P provides services on behalf of the corporation.

Importantly, the Paper recognises that any "failure to prevent fraud" offence should not apply either to attempts or to conspiracies.[15] While it is reasonable to expect corporations to put in place

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[11] This Option reflects the Canadian approach, alongside the definition of "senior management" contained in the Corporate Manslaughter and Corporate Homicide Act 2007. While there was no consensus, the Canadian model was broadly preferred to the Australian (Paper, §4.38), under which the focus would be on "high managerial agents".

[12] Pursuant to which a company could be liable for any criminal conduct by an employee or agent acting within the scope of their employment with an intent to benefit the company. This is the approach adopted in the United States.

[13] In the federal Criminal Code of Australia, "corporate culture" is defined as *"an attitude, policy, rule, course of conduct or practice existing within the body corporate generally to in the part of the body corporate in which the relevant activities take place"* (Criminal Code Act (Cth) s. 12.3(6)).

[14] There are two 'failure to prevent' offences under English law (though they differ in scope): s.7 Bribery Act 2010 and ss. 45 and 46 of the Criminal Finances Act 2017. Under both, it is a defence for the corporation to show that it had in place such prevention procedures as it was reasonable in all the circumstances to expect the company to have in place. Respondents also noted that a broader "failure to prevent" offence would effectively duplicate the current anti-money laundering rules: Paper, §8.99.

procedures to prevent employees and agents from carrying out a fraud, it would be difficult to prevent employees and agents from merely agreeing or attempting to commit fraud. This is plainly sensible, not least as a core principle from which the consultation proceeded is that businesses should not be disproportionately burdened.[16]

The company would have a defence where it could prove that it had in place such prevention procedures as were reasonable in the circumstances. In opting for "*reasonable*" over "*adequate*" procedures, the Paper expressly recognises widespread dissatisfaction with the latter qualifier in the context of s.7 Bribery Act 2010 (which has, in any event, been construed to mean 'reasonable' by the House of Lords' Select Committee).[17] The Government would issue public guidance on the procedures that organisations might put in place, much like in the equivalent bribery context.[18]

In addition to the *"failure to prevent fraud"* offence, the Paper outlines three further failure to prevent options for human rights abuses (§8.127); ill-treatment or neglect (§8.145); and computer misuse offences (§8.156).

By contrast to the existing failure to prevent regimes, the Law Commission concluded that *"there should not be any default expectation that any future failure to prevent offences should have extraterritorial effect. A failure to prevent offence should only be extended to cover conduct overseas when there is a demonstrable need for extraterritoriality in relation to that offence specifically."*[19]

This approach is anomalous given the extraterritorial reach of the Bribery Act 2010. It is not easy to see why any '*failure to prevent fraud*' offence should not be similarly expansive given the global reach of many UK-based corporations, and the policies of (a) deterrence and (b) promoting a healthy corporate culture that underpin, or should underpin, these reforms.

(3) Administrative & Civil Options

In considering administrative and civil avenues the Paper recognises that a key advantage of this approach would be to avoid taxing the criminal justice system with cases that might be considered "regulatory". Given the pressure under which the criminal justice system currently operates, and valid questions over whether juries are best placed to judge corporate conduct (or determine whether complex financial misconduct has occurred) this advantage should not be underestimated.

Nonetheless, and contrary to the submissions of several respondents, the Paper makes plain that the Commission intends for civil regimes to operate alongside corporate criminal liability where there is insufficient evidence to prosecute, not as a substitute.[20]

(a) Administratively Imposed Monetary Penalties

The Paper considers three administrative options entailing monetary penalties in cases where (a) fraud is perpetrated by an associated person intended to benefit the corporation, and (b) the company is unable to show that it took reasonable precautions to prevent the offence from occurring. The options considered are:

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[15] Paper, §8.88.
[16] Paper, §1.3.
[17] https://www.parliament.uk/globalassets/documents/lords-committees/Bribery-Act-2010/govt-response-hol-select-committee-bribery-act-2010.pdf pp.15-16.
[18] Ministry of Justice, "*Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing.*" (2011).
[19] Paper, §8.67.
[20] Paper, §11.8.

1. A regime by which detailed positive obligations are imposed on corporations together with penalties for failures to comply. This was likened to the FCA's current regulatory oversight of the financial services sector.
2. A regime of general obligations to avoid fraud by an associated person, but with more flexibility as to how that end is achieved.
3. A regime under the current framework of the Regulatory Enforcement and Sanctions Act 2008.

Each would entail the imposition of penalties enforceable as civil debts, with a right of appeal first to an independent tribunal and ultimately to the civil courts.[21]

The Paper rejects Options 1 and 3. The first was thought to be a "huge task" and faced considerable resistance from the FCA, which noted both the potential for disproportionately burdening corporations in low-risk sectors, and that it would be unrealistic to extend any one of the Principles in the FCA Handbook to the corporate sphere without including the more detailed obligations and guidance that underpin them. Yet doing that, rightly, was thought capable of resulting in unjustified over-regulation. It would also likely require the creation of a new regulator.

The third option was rejected summarily: not only is the CPS currently excluded from the operation of RESA 2008, but the power of Ministers to specify offences for which regulators can impose civil sanctions is expressly limited to offences existing at the time of the coming into force of the Act. Reform was rejected on the basis that it would be contrary to the Act's original intention.

The second option looks to four existing regimes of monetary penalties where a specified regulator is given powers to investigate wrongdoing.[22] The Commission considered that this structure could prove a viable alternative. Although we agree, we can foresee real practical difficulties if any such system is ultimately operated through either the SFO or the CPS.

In addressing under which agency's auspices that regime would operate (the contenders being the CPS and SFO), the Paper proposes joint oversight, which coheres with the present system of supervision over cases of suspected criminal fraud. In response to the objection that this would give the SFO and CPS quasi-judicial functions, the Paper notes that this duality already exists elsewhere (as in the FCA) and that *"by making corporate failure to prevent fraud a civil wrong only, there would be no issue concerning whether the authorities were going to take criminal or civil action. Instead, there would be a clear dividing line between fraud (a crime) and a failure to prevent fraud (a civil wrong if committed by a corporation)."*[23]

The Paper does however acknowledge that this proposal would require restructuring both the CPS and the SFO to create new sub-divisions with powers to impose monetary penalties. Interestingly given its special interest in this proposal, the CPS opposed it on the basis that any such restructuring process would have significant resource and structural implications. This concern seems justified: insofar as a key advantage of using civil regimes is to avoid overburdening the criminal justice system, that could be significantly undermined by seeking to implement any new regime through the CPS, which would, under this system, have to face civil appeal proceedings in addition

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[21] Paper, §11.11.
[22] Market abuse and insider dealing; price-fixing and other anti-competitive practices; breach of financial sanctions legislation; and the obligations of relevant persons against money-laundering and terrorist financing.
[23] Paper, §11.95.

to its current workload. It may be that any monetary penalties imposed could, in the future, be used to fund the CPS, though the Paper is silent on this point.

(b) Resolution through the High Court

The Paper proposes three other civil-law Options operating directly through the High Court:

- Option 9. Civil actions in the High Court,[24] based on Serious Crime Prevention Orders, but involving a power to impose monetary penalties as well as preventative measures that the company would be required to take.
- Option 10A. A reporting requirement based on section 414CB of the Companies Act 2006, requiring public interest entities to report on anti-fraud procedures.
- Option 10B. A reporting requirement based on section 54 of the Modern Slavery Act 2015, requiring large corporations to report on their anti-fraud procedures.

An interesting feature of proposed Option 9 would be the introduction of DPA-style resolution processes supervised by the High Court.[25] But a key outstanding question is whether the civil courts' costs' regime,[26] which, it is suggested, acts as a strong disincentive for regulators' use of the civil courts, could also be reformed.[27] The Law Commission is in favour of reform, noting that *"for any future expanded civil law regime to be successful, consideration should be given as to whether the costs regimes associated with it makes it unattractive to law enforcement agencies"*. We agree, though while the Commission appears at pains to avoid unduly burdening regulators, it is plainly sensible that some costs' protection for defendants arising out of obviously unreasonable, dishonest or other improper conduct on the part of the regulator should also be included.

Next Steps & Timing

It is now for the government to consider the Options Paper and implement a plan for reform, though no timeline has been mooted for that. It is at least possible that any reform could form part of the second round of legislation tackling economic crime the government announced earlier this year. The passage of the Economic Crime (Transparency and Enforcement Act) 2022 demonstrates considerable appetite in government for tackling economic crime, or at least for keeping that goal at the top of the agenda. We may therefore see developments in this area sooner rather than later.

Summary of all Ten Options

1. Retention of the identification doctrine as at present.
2. (a) Allowing conduct to be attributed to a corporation if a member of its senior management engaged in, consented to, or connived in the offence. A member of senior management would be any person who plays a significant role in the making of decisions about how the whole or a substantial part of the organisation's activities are to be managed or organised, or the actual managing or organising of a substantial part of those activities.
2. (b) As 2(a), with the addition that the organisation's chief executive officer and chief financial officer would always be deemed to be members of its senior management.

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[24] Though the possibility of such orders being made by a High Court judge sitting in the Crown Court is also acknowledged.
[25] Paper, §12.40.
[26] i.e. one that allows costs-shifting that is ultimately at the Courts' discretion, and over which satellite litigation is common. See Paper, §§12.106 et seq.
[27] See the NCA's Unexplained Wealth Order litigation in ***NCA v Baker*** [2020] EWHC 822 (Admin) in which the respondents claimed £1.5m in costs. The Economic Crime (Transparency and Enforcement) Act 2022 now limits the recoverability of costs in such circumstances.

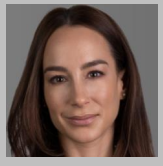
3. An offence of failure to prevent fraud by an associated person. The offence would be committed where an associated person (who might be an employee or agent) commits an offence of fraud with intent to benefit the corporation, or to benefit another person to whom they provide services on behalf of the corporation.
4. An offence of failure to prevent human rights abuses.
5. An offence of failure to prevent ill-treatment or neglect.
6. An offence of failure to prevent computer misuse. If any of these options were taken forward, further work and consultation would be necessary on the scope of the offences.
7. Make publicity orders available in all cases where a non-natural person is convicted of an offence.
8. A regime of administratively imposed monetary penalties.
9. Civil actions in the High Court, based on Serious Crime Prevention Orders, but involving a power to impose monetary penalties.
10. (a) A reporting requirement based on section 414CB of the Companies Act 2006, requiring public interest entities to report on anti-fraud procedures.
10. (b) A reporting requirement based on section 54 of the Modern Slavery Act 2015, requiring large corporations to report on their anti-fraud procedures.

ABOUT THE AUTHORS

Nicholas Medcroft QC

Silk 2019

Nicholas has particular expertise of issues which straddle civil and criminal law. He has experience of all aspects of financial crime, including bribery and corruption, money laundering, market abuse and fraud. He has particular expertise in acting for banks caught up in fraud and money laundering, both in the context of civil claims and in the context of FCA and SFO investigations. Nicholas is ranked in the legal directories for Financial Crime and is described as "a market leader in financial crime and fraud relating to financial services".



Leonora Sagan

Call 2012

Leonora Sagan has a broad commercial, civil fraud and business crime practice representing corporations, financial institutions and high-net-worth individuals in complex disputes and investigations. She is recognised by *The Legal 500* and *Chambers & Partners* as a leading junior in Business and Financial Crime and is described as having "a sharp, systematic mind and deep knowledge of her area".