Ministry of Justice: Call for Evidence on Corporate Liability for Economic Crime

The Law Society of England and Wales Response

March 2017
Introduction

1. The Law Society of England and Wales is the representative body for over 170,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and government in both a domestic and European arena.

2. The Society welcomes the opportunity to respond to the Ministry of Justice's Call for Evidence on Corporate Liability for Economic Crime.

Executive Summary

3. The Law Society believes that the case has not been made out for the reform of the Identification Doctrine through amendment of the doctrine or the introduction of new corporate criminal offences. We agree with the Law Commission’s conclusion in its 2010 consultation paper Criminal Liability in Regulatory Contexts that ‘there is no pressing need for statutory reform or replacement of the identification doctrine’.

4. Strong corporate governance is essential for creating and maintaining a business environment based on trust, transparency and accountability. The UK already has in place strong criminal and regulatory regimes which support its international reputation as an attractive place with which to do business. It is not clear to us that the benefits of any of the Options presented in the Call for Evidence would add to the UK’s standing, or outweigh the costs of compliance and the potential duplication with existing regulatory regimes and other parts of the criminal law framework.

5. There are a number of agencies such as the Financial Conduct Authority (FCA), the National Crime Agency, Her Majesty’s Revenue and Customs and the Serious Fraud Office (SFO) with wide-ranging investigatory and enforcement powers which they put to good effect. Companies in the financial sector face substantial penalties for corporate governance breaches. In 2014 British banks paid £12.6bn in penalties to settle legal and regulatory disputes.¹ A 2015 Ernst & Young report on how ‘regulators are getting tougher on financial crime’ estimated that various authorities issued £2.45bn worth of fines that year; a 271% increase over the previous two years.² The SFO has recently completed a £497.25m Deferred Prosecution Agreement with Rolls-Royce PLC. These are very significant sanctions.

6. The Bribery Act 2010 regime is now in place, and the Criminal Finances Bill offence of failure to prevent the facilitation of tax evasion is currently before Parliament. The FCA’s Senior Managers and Certification Regimes (SM&CR), which is specifically directed at ensuring the accountability of senior managers in the financial services sector, was only launched in March 2016 and should be given time to become embedded before any additional regime is introduced.

7. In such a complex landscape, additional laws would almost certainly require businesses, particularly in the financial sector, to develop new training and compliance frameworks at a time when they are already facing significant compliance-related costs.³

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¹ British banks pay £12bn in penalties, Financial Times (31 May 2015), www.ft.com/content/3389707c-0790-11e5-a58f-00144feabdc0
³ In 2014 HSBC spent $750 - $800m on compliance-related costs. See www.ft.com/content/0e3f0760-1bef-11e4-9666-00144feabdc0
8. If the government is minded to pursue legislative change, we would support the Law Commission’s preference for what it calls ‘context-sensitive reform’, so that criminal liability would be attributed to companies on a more specific offence-by-offence basis. That would suggest a less-sweeping approach than the failure-to-prevent Bribery Act model under Option 4.
I. Comments on the options presented in the Call for Evidence

Option 1: Amendment of the identification doctrine

9. We would not recommend this option. The Law Commission’s *Criminal Liability in Regulatory Contexts* paper stated that ‘it is unlikely that having only one basis on which companies can be found criminally liable, however broadly stated, will prove to be workable or desirable across the board. Recent legislation in fact points in the opposite direction, namely in the direction of specially tailored solutions to fit different contexts in which crimes may come to be committed by, or on behalf of, companies.’ The paper further noted that ‘there is no pressing need for statutory reform or replacement of the identification doctrine. That doctrine should only be applied as the basis for judging corporate conduct in criminal law if the aims of the statute in question will be best fulfilled by applying it.’

10. The FCA’s recently enacted SM&CR\(^4\) aims to hold to account individual managers of financial institutions for control failings. Amending the identification doctrine to broaden the scope of those considered to be a directing mind of a company could subject managers to both the SM&CR and a broadened definition of directing mind. Overlapping regulatory and criminal frameworks will raise practical difficulties. For example, a manager’s response to a regulatory investigation might be very different to a criminal investigation in which the manager could exercise their right not to self-incriminate.

11. Even with an amended identification doctrine that reflects a broadened scope of 'directing mind', organisations that are determined to prevent criminal actions from being attributed to a directing mind could find creative ways of doing so. Amending the identification doctrine to broaden the scope of a 'directing mind' might even lead to changes in corporate governance in smaller companies with relatively simple organisational structures.

Option 2: Strict (vicarious) liability offence

12. This option, combined with a due diligence-style defence, might lead to improved corporate governance. Without a due diligence defence companies could become criminally liable for the actions of employees, representatives or agents even when such actions directly contradict a company’s policies and are not taken for the benefit of the company. US federal law allows criminal liability to be attributed to a company under the doctrine of *respondeat superior*, but for a company to be criminally liable, its officers, employees, or agents who have engaged in wrongdoing must have acted within the scope of their employment and with some benefit to the company.\(^5\)

Option 3: Strict (direct liability) offence

13. This option, coupled with a due diligence type defence, could offer companies some degree of familiarity, because it is similar to the framework under section 7 of the Bribery Act and the proposed facilitation of tax evasion offence in the Criminal Finances Bill. For that reason, it might be an attractive public policy option.

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\(^4\) The SM&CR started on 7 March 2016.

14. However, this option raises questions of proportionality and predictability as large, complex organisations would have to prove that they have the internal controls aimed at preventing economic crime. Unlike the Bribery Act, which is tailored to address bribery-related offences, and the tax fraud component of the Criminal Finances Bill, which is tailored to prevent tax fraud, the scope of non-bribery and non-tax-related corporate economic crime could be very broad.

15. The Call for Evidence lists four common serious economic crime offences that could be included, as a starting point, in a new failure to prevent offence: three of those offences are currently addressed through existing legislation and one is a common law offence. Overlaps between existing law and a failure-to-prevent model might make it more difficult for companies to develop and implement effective and consistent compliance models. Arguably, law enforcement should be using existing law more often and more robustly.

Option 4: Failure to prevent as an element of the offence

16. This option, coupled with a due diligence type defence, would be preferable to option 3 because it would require the prosecution to prove that a company has not implemented adequate measures to prevent economic crime; the burden of proof would be on the Crown in all aspects of the offence. Companies would need more clarity about the scope of liability for individuals whose actions could be imputed to the company. Actions by contractors or suppliers should be excluded from the scope of a new offence. As in the United States, for the company to be criminally liable, employees, agents or representatives must act for the benefit of the company.

17. The prosecution bearing the burden of proof does not dispose of the need to carefully assess whether measures to address corporate criminal liability for economic crime are necessary, as companies might implement costly, duplicative and potentially unnecessary controls out of fear of successful prosecutions.

Option 5: Investigate the possibility of regulatory reform on a sector by sector basis

18. This option would require a significant resource commitment, but a sector-by-sector approach to determining the possibility (and the need) for regulatory reform could avoid the uncertainty, duplication and inefficiencies associated with applying a one-size-fits-all approach to diverse companies operating in diverse sectors.

19. This would be particularly important for companies in the highly regulated financial sector as they could avoid the uncertainty and increased costs associated with duplicative or inconsistent laws. There is already a great deal of uncertainty around the UK's financial sector.
II. Responses to the Call for Evidence Questions

Question 1. Do you consider the existing criminal and regulatory framework in the UK provides sufficient deterrence to corporate misconduct?

20. No regime can be watertight, but in our view the existing criminal and regulatory framework in the UK, certainly as it applies to companies in the financial sector, provides a deterrent to corporate misconduct. It is not clear to us that the options identified in the Call for Evidence would make a significant difference to that effectiveness.

21. Companies in the UK’s financial sector must comply with an array of regulations, many of which expose individual wrongdoers to criminal liability and companies to significant fines. In recent years, companies in the financial sector have had to implement regulatory changes ranging from the 2010 Bribery Act to the FCA’s SM&CR. The Criminal Finances Bill currently before Parliament will soon introduce a widely-drawn corporate offence of facilitating tax evasion. The Bribery Act and SM&CR should be given enough time to take effect as they could lead to broad changes in corporate governance and senior management accountability.

Question 2. Do you consider the identification doctrine inhibits holding companies to account for economic crimes committed in their name or on their behalf?

22. Although there are difficulties associated with using the identification doctrine to hold companies to account for economic crimes, these difficulties must be weighed against the cost of implementing the various options presented in the call for evidence. Please see our responses in section I.

Question 3. Can you provide evidence or examples of the identification doctrine preventing a corporate prosecution?

23. We are not able to provide any evidence or examples; this question is probably one for law enforcement.

Question 4. Do you consider that any deficiencies in the identification doctrine can be remedied effectively by legislative or non-legislative means other than the creation of a new offence (Option 1)?

24. All of the Options have potential, but they also all have drawbacks and all would come with increased compliance costs. Please see paragraphs 12-19.

Question 5. If you consider that the deficiencies in the identification doctrine dictate the creation of a new corporate liability offence which of options 2, 3, 4, or 5 do you believe provides the best solution?

25. We are not convinced that the deficiencies in the identification doctrine do dictate the creation of a new corporate liability offence.

Question 6. Do you have views on the costs or benefits of introducing any of the options, including possible impacts on competitiveness and growth?

26. A reputation as a jurisdiction with high financial regulatory standard could attract investment to the UK; on the other hand, a new corporate liability for economic crime could increase the compliance burden faced by companies. It is difficult for us to assess
that balance or to assess how the financial services sector in particular is likely to perform over the next few years.

**Question 7: Do you consider that introduction of a new corporate offence could have an impact on individual accountability?**

27. The introduction of a new corporate offence could have an impact on individual accountability. Under options 3 and 4, senior managers who fail to implement adequate controls aimed at preventing corporate economic crime could face adverse consequences from a company’s owners and other stakeholders. The extent of any impact is difficult to predict. The FCA’s SM&CR, although only recently enacted, is focused on holding individual managers to account for certain failings.

**Question 8: Do you believe new regulatory approaches could offer an alternative approach, in particular can recent reforms in the financial sector provide lessons for regulation in other sectors?**

28. Regulators in the financial sector have tools for penalising companies and individuals for economic crime. More time is needed to assess the impact of the SM&CR on the behaviour of senior managers, and to determine whether any best practices can be applied to other sectors. A 2016 British Bankers’ Association briefing on reforms since the financial crisis stated that over 80 pieces of legislation have been implemented to make the financial system more stable and secure.⁶

**Question 9: Are there examples of corporate criminal conduct where a purely regulatory response would not be appropriate?**

29. We have not been able to consider this question fully.

**Question 10: Should you consider reform of the law necessary do you believe that there is a case for introducing a corporate failure to prevent economic crime offence based on the section 7 of the Bribery Act mode?**

30. Please see our responses in section I.

**Question 11: If your answer to question 10 is in the affirmative, would the list of offences listed above, coupled with a facility to add to this list by secondary legislation, be appropriate for an initial scope of the new offence? Are there any other offences that you think should be introduced within the scope of any new offence?**

31. Please see our responses in section I.

**Question 12: Do you consider that the adoption of the failure to prevent model for economic crimes would require businesses to put in place additional measures to adjust for the existence of a new criminal offence.**

32. New laws or regulations often lead to costs related to implementing or modifying compliance systems. The Advisory, Conciliation and Arbitration Service in a 2015 report estimated that, on average, small-to-medium-sized enterprises spent £3,740 on professional advice related to the Bribery Act and £2,730 on implementing bribery prevention procedures.⁷ The scale of such costs for larger businesses could be several

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⁶ *Reforms since the Financial Crisis*, British Bankers’ Association (January 2016), www.bba.org.uk/download-file/?

orders of magnitude greater.

**Question 13:** Do you consider that the adoption of these measures would result in improved corporate conduct?

33. Please see our responses in Section I.

**Question 14:** Do you consider that it would be appropriate for any new form of corporate liability to have extraterritorial reach? Do you have views on the practical implications of such an approach for businesses?

34. A new form of corporate liability which has extraterritorial reach would make more complex the potential jurisdictional duplication that companies face. It is clear that the extra-territorial reach of the proposed offences in the Criminal Finances Bill will present significant compliance challenges.

**Question 15:** Is a new form of corporate liability justified alongside the financial services regulatory regime? If so, how could the risk of friction between the operation of the two regimes be mitigated?

35. A new form of corporate liability in respect of companies in the financial sector, is not currently justified alongside the financial services regulatory and law enforcement regime.

**Question 16:** What do you think is the correct relationship between existing compliance requirements in the financial services sector and the assessment of prevention procedures for the purposes of a defence to a criminal charge?

34. If a new form of corporate liability were to be introduced, the relationship between regulatory compliance requirements and the assessment of prevention procedures for the purposes of a defence to a criminal charge should be clarified.

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