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Changes to Corporate Criminal Liability in the UK – The Economic Crime and Corporate Transparency Act 2023

Patrick Rappo

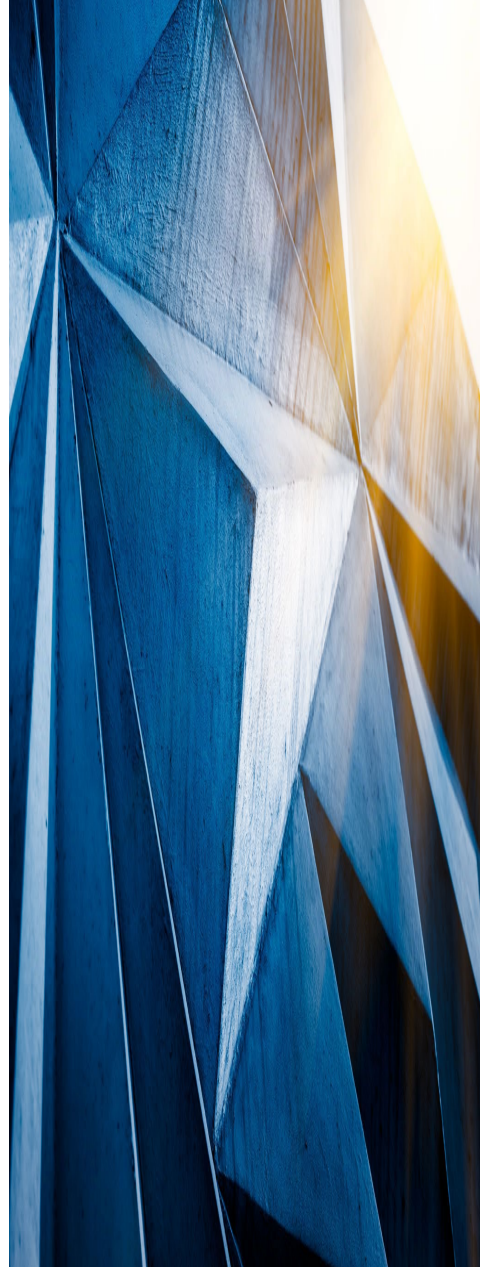
Partner

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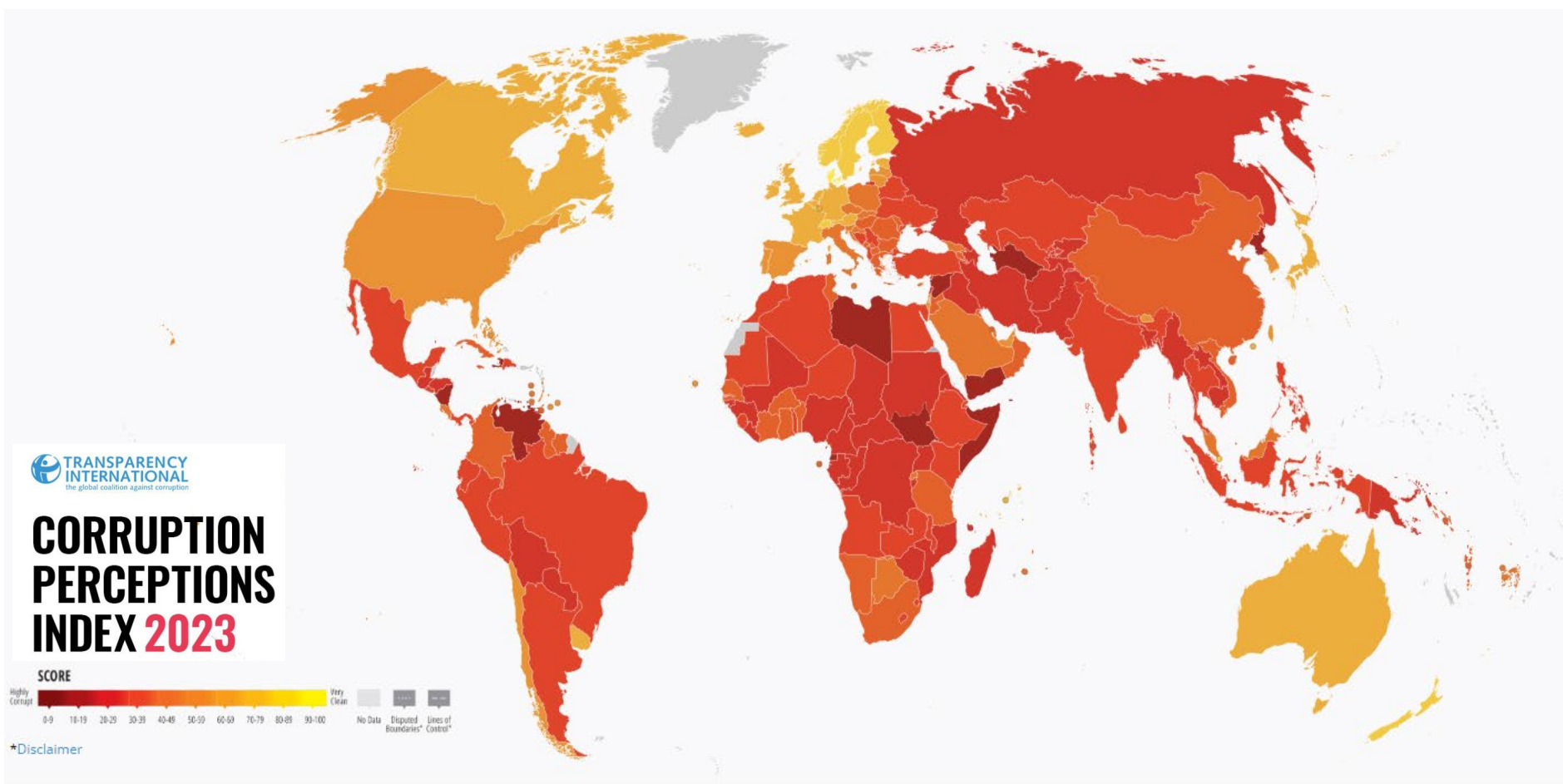
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1. Introduction
2. Expansion of the Identification Principle
3. Failure to Prevent Fraud
4. Practical Considerations



Introduction

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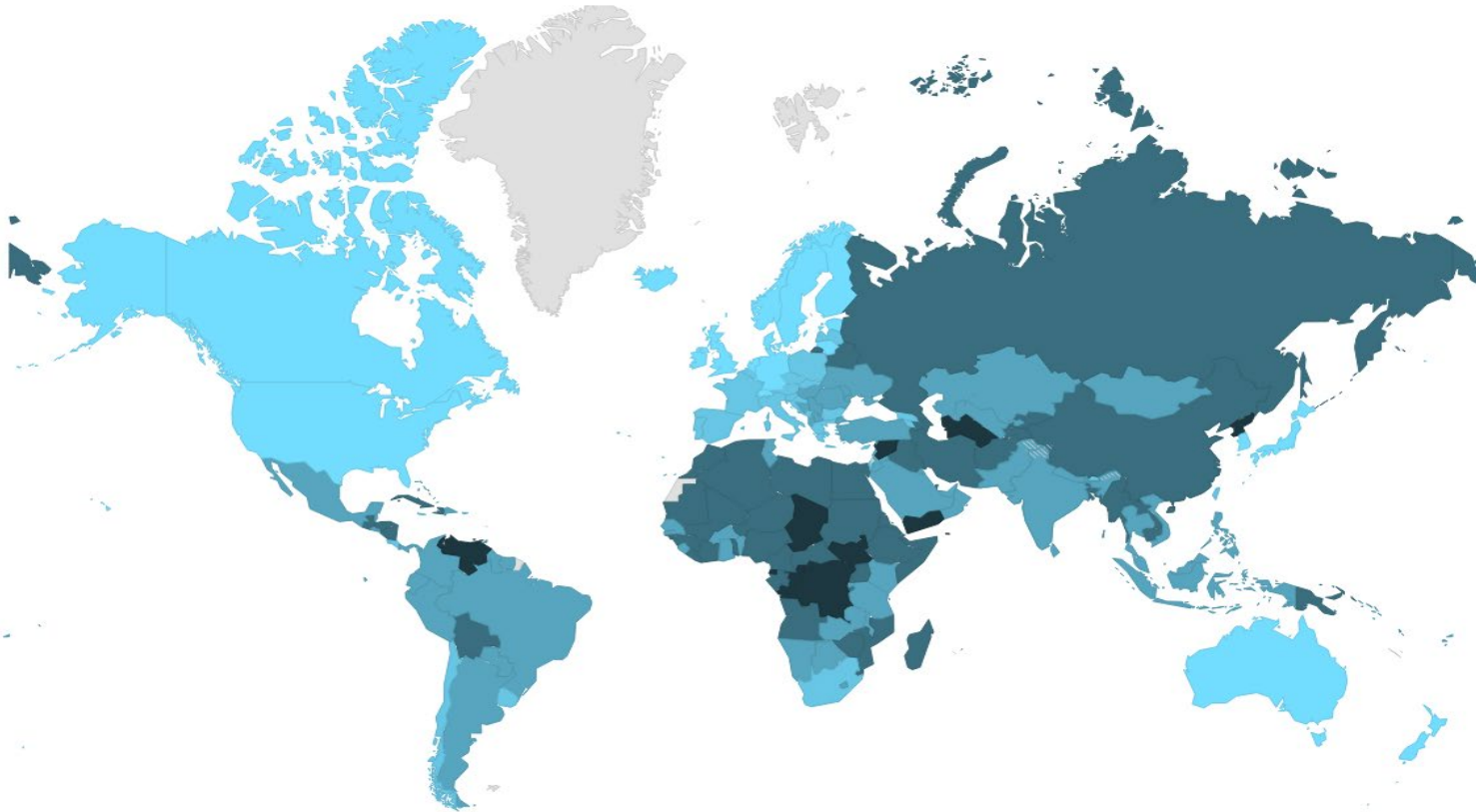


- Transparency International estimate that corruption costs the Global Economy **\$2.6 trillion** every year
- It is estimated that around **£100 billion** of dirty money passes through the UK and its local systems every year

Global Enforcement Hotspots

2023 RESULTS

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- The Home Office Economic Crime Survey found that 20% of UK businesses have experienced or been victims of fraud

The Economic Crime and Corporate Transparency Act 2023

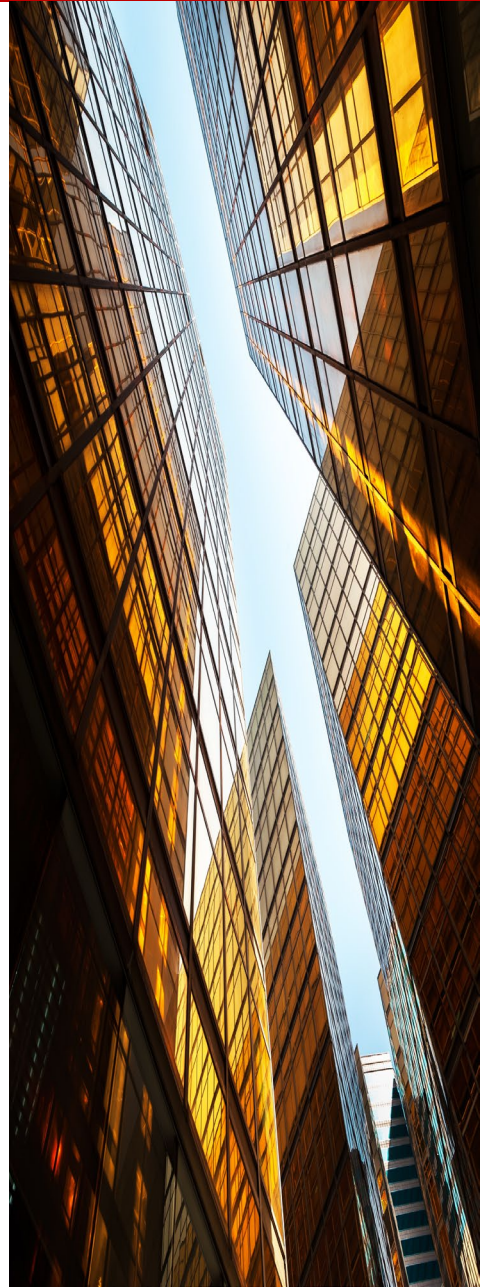
- The Act represents a significant turning point for the law on corporate criminal liability in the UK and has been welcomed by prosecutors such as the Serious Fraud Office.
- The Act will strengthen the powers of law enforcement agencies, improve transparency over UK companies, make it easier to prosecute corporates for certain financial crimes, and introduce a new failure to prevent fraud offence.
- Law enforcement agencies have long been calling for these reforms.
- Nick Ephgrave, the new director of the Serious Fraud Office, stated that the Act is "***the most significant boost to the [SFO]'s ability to investigate and prosecute serious economic crime in over 10 years***".

Introduction

The Act covers a number of areas, including:

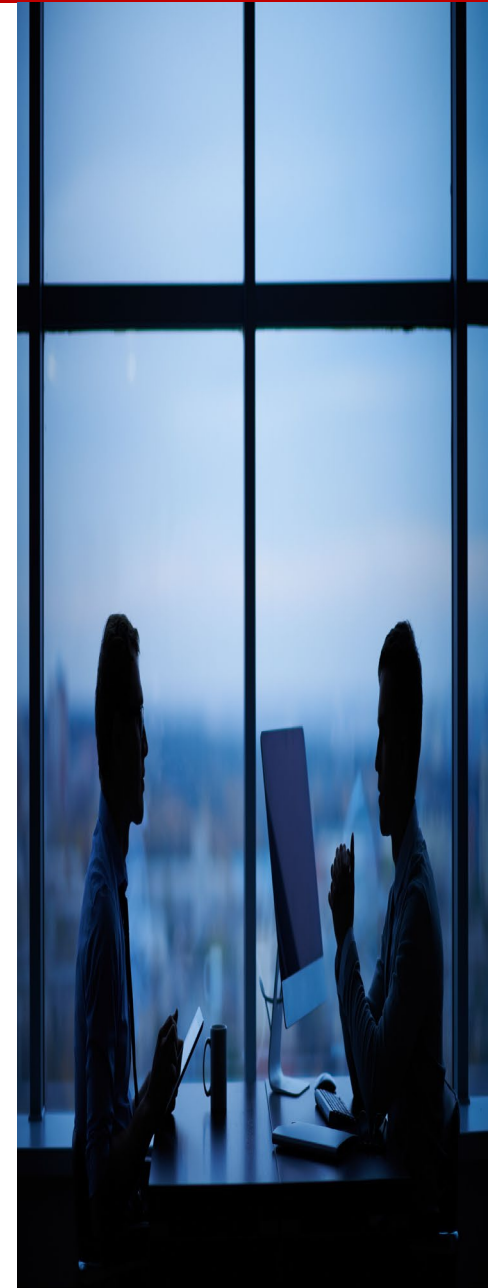
- Changes to Companies House, which improve transparency over UK entities.
- The National Crime Agency has gained greater powers to compel businesses to hand over information regarding suspected money laundering and terrorist financing.
- SFO's powers to compel individuals and companies to provide pre-investigation information have been expanded in an effort to speed up investigations. Under the previous legislation, the SFO was only able to use these pre-investigation powers in relation to overseas bribery and corruption cases where it had "reasonable grounds to suspect" that such a crime had been committed.
- Section 211 of the Act has expanded these powers to all potential SFO cases at the pre-investigative stage, including fraud, domestic bribery, and corruption.

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Introduction

- Most significantly, the Act also introduces two fundamental changes to the UK's corporate criminal liability regime with respect to economic crime:
 - **The expansion of the identification principle; and**
 - **The introduction of a failure to prevent ("FTP") fraud offence.**
- The impetus for these reforms lies in the historic difficulties that prosecutors have encountered when seeking to prosecute corporate entities due to the much-maligned "identification principle", as well as the rising levels of economic crime, and particularly fraud, in the UK.



Expansion of the Identification Principle

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Expansion of the Identification Principle

The old test: "directing mind and will"

- The identification doctrine governs the *mens rea* requirement for corporate criminal liability.
- Under the "directing mind and will" test, a corporate could only be held criminally liable if the commission of an offence could be attributed to a natural person who could be said to represent its "directing mind and will" at the time the offence was committed.

Tesco Supermarkets Ltd v Nattrass [1971] UKHL 1

- In practical terms, this represented a very narrow group of individuals and was a difficult threshold to attain, particularly in the context of large corporates with complex management structures.
- The test has long been criticised, as it limits corporate criminal liability to crimes committed directly by the highest-ranking executives.

SFO v Barclays Plc & Anr [2018] EWHC 3055 (QB)

- The "directing mind and will" was narrower than the approach taken in other jurisdictions. US for instance follows a respondeat superior model of corporate criminal liability under which companies can be held criminally liable for the activities of their employees and agents at any level, and their acts are motivated by an intent to benefit the corporation.

Expansion of the Identification Principle

The new test: actions committed by a “senior manager”- section 196

- The Act has replaced the "directing mind and will" test with a new **"senior manager"** test taken from s1(4)(c) Corporate Manslaughter and Corporate Homicide Act 2007 (CMCHA).
- Rather than relying on the identification principle, under the new legislation, the corporate entity will be liable for actions committed by a “senior manager”.
- This significantly expands the group of individuals through which liability can be attributed to a company, making it easier for prosecutors to successfully pursue corporates.

Expansion of the Identification Principle

Corporate liability – an organisation will be guilty of a “**relevant offence**” if that offence is committed by a “**senior manager**” of the organisation acting within the actual or apparent scope of their authority.

Relevant offence – listed in **Schedule 12** of the Act covers a broad range of offences and includes theft, various fraud and tax offences, bribery offences under the Bribery Act, money laundering offences under the Proceeds of Crime Act 2002 and terrorist financing offences under the Terrorism Act 2000.

Senior managers - are defined as individuals who play a **significant role** in:

- (i) the making of decisions about how the whole or a substantial part of the activities of the body corporate are to be managed or organised, or
 - (ii) the actual managing or organising of the whole or a substantial part of those activities.
- Critically, the wording looks at the substance of an individual’s role rather than their title.
 - There is no case law to date interpreting the definition of “senior manager”.
 - Ministry of Justice Guidance for the CMCHA states that “*apart from directors and similar senior management positions, roles likely to be under consideration include regional managers in national organisations and managers of different operational divisions*”.

Geographic scope – If no act forming part of the relevant offence takes place in the UK, an organisation will not be guilty of an offence unless it would be guilty of the relevant offence in the country where it was committed.

Failure to Prevent Fraud

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Failure to Prevent Fraud

Section 199 provides that a large organisation commits the failure to prevent fraud offence if it fails to prevent an associated person from committing a fraud offence, where the associated person intends to benefit (directly or indirectly) either:

- the organisation, or
 - the person to whom the associated person provides services on behalf of the organisation.
- The failure to prevent fraud is narrowly drafted in terms of who can commit it – i.e. **only large organisations**. This is despite efforts by the House of Lords to extend the scope of the offence.

Section 201 defines a large organisation as one in which two or more of three measures are exceeded:

- More than 250 employees;
- More than £36 million turnover; and/or
- More than £18 million in aggregate assets on its balance sheet.

"Associated Person" is defined as an employee, agent or subsidiary of the organisation (as well as any others who perform services for or on its behalf).

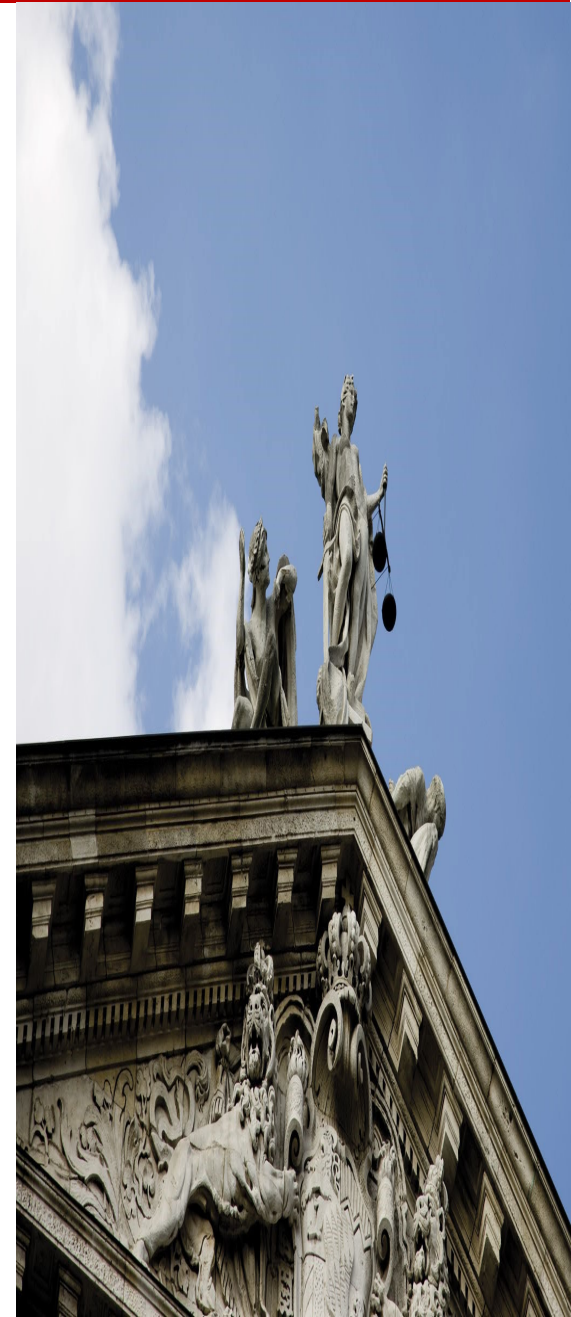
- The failure to prevent fraud offence has wide extraterritorial effect.
- If an Associated Person commits fraud under UK law, or targeting UK victims, the organisation could be prosecuted, even if the organisation (and the Associated Person) are based overseas.

Failure to Prevent Fraud

Specific fraud offences

- **Specified fraud offences** are listed in **Schedule 13** to the Act and include fraud by false representation, fraud by abuse of position, and fraud by failing to disclose information.
- These wide-ranging offences are all conduct-based offences. It is not necessary to prove any resulting loss or damage.
- With one exception the Schedule 13 offences all require proof of **dishonesty**. The odd one out is section 19 of the Theft Act 1968, which, instead of dishonesty, requires an intention to deceive.
- **Section 200** empowers the Secretary of State to pass secondary legislation to add or remove offences from this schedule. However, only offences of dishonesty, offences of a similar character to the existing offences or money laundering offences contrary to sections 327-329 of the Proceeds of Crime Act 2002 may be added.

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Failure to Prevent Fraud

Relevant fraud offence- which offences can be an underlying fraud?

•Fraud Act 2006 (Fraud Act) offences, namely:

- Fraud by false representation (section 2 Fraud Act 2006)
- Failing to disclose information (section 3 Fraud Act 2006)
- Fraud by abuse of position (section 4 Fraud Act)
- Participating in a fraudulent business (section 9, Fraud Act 2006)
- Obtaining services dishonestly (section 11, Fraud Act 2006)

•Theft Act 1968 (Theft Act) offences, namely:

- False accounting (section 17, Theft Act);
- False statements by company directors (section 19, Theft Act);

•Cheating the public revenue (common law offence)

•Fraudulent trading under section 993, Companies Act 2006 (Companies Act).



Failure to Prevent Fraud

Relevant fraud offence- which offences can be an underlying fraud?

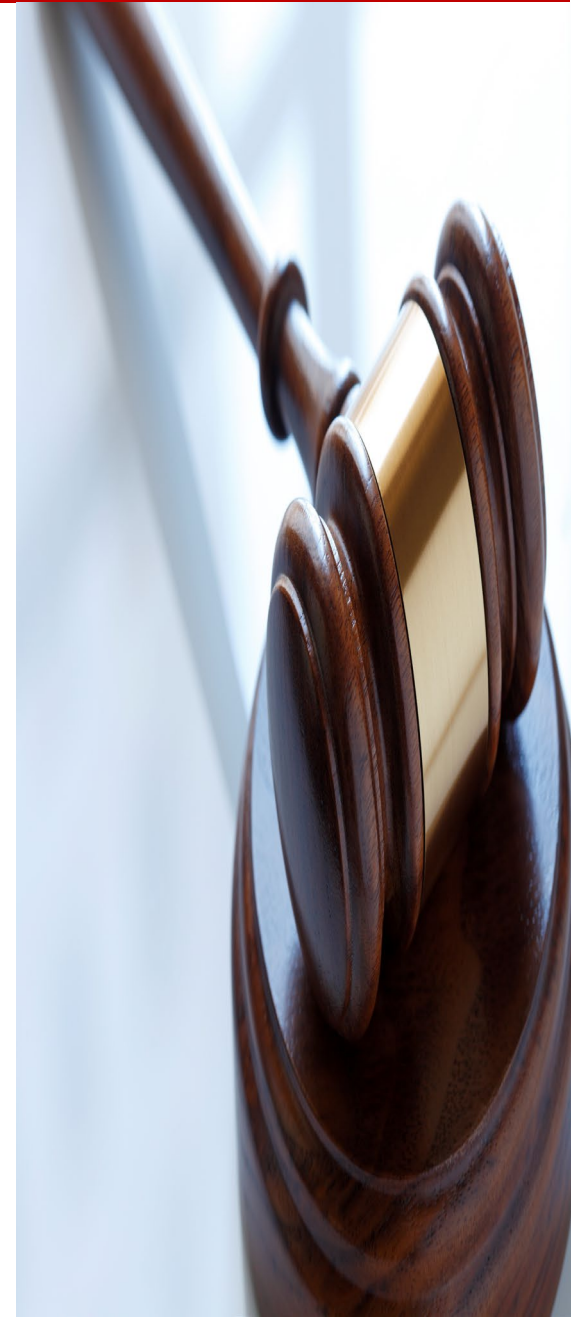
The types of conduct that could be caught are broad.

- Offences could arise out of warranties and representations made in transaction documents, prospectuses, annual reports, and insurance claims.
- Crucially, there would have to be **dishonest intent** for an offence to be committed. According to Home Office Guidance conduct caught will include “dishonest sales practices, false accounting and hiding important information from consumers or investors” and “dishonest practices in financial markets”.
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- The cheating the public revenue element of this new offence may also cross over with organisations’ existing obligations under the failure to prevent tax evasion offences introduced under the Criminal Finances Act 2017 and so it may be possible for organisations to build on existing procedures already in place in this regard.

Failure to Prevent Fraud

Defence

- The organisation will only have a **defence** if it can show it either had "**reasonable procedures**" in place to prevent the fraud, or that it was not reasonable for the organisation not to have such procedures in place.



Failure to Prevent Fraud

No liability if the company is a **victim**

- The Act provides an important exemption where the company was or was intended to be a **victim of the fraud offence**. This means a corporate will not be liable where an associated person **commits a fraud offence for their own benefit**, rather than for the benefit of the company.
- The use of “victim” in the Act presupposes that there can be multiple victims of the same fraud.
- If the company can show that it was one of the intended victims of the associated person’s fraud , it does not commit the failure to prevent fraud offence (even though there may be other victims who have lost much more).

Failure to Prevent Fraud

Who is the victim?

- If a director makes a false statement intending to deceive shareholders about the company's financial affairs, contrary to section 19 of the Theft Act 1968, those shareholders are not the only victims of the fraud.
- The director is likely to be seeking to enrich himself personally (through the false statement) at the expense of the company.
- In such an example, the associated person has the required *mens rea* to commit a Schedule 13 offence but has no additional *mens rea* in intending to cause loss to the company which means that the company would not be liable under the failure to prevent fraud offence.



Failure to Prevent Fraud

Extra-Territorial Effect of the Act

Jurisdictional scope of the Fraud Act, Theft Act and common law offences

- A relevant fraud offence may be committed where not all of the underlying criminal conduct takes place in England and Wales.
- Save for the Companies Act offence of fraudulent trading, the above predicate offences all have a degree of extraterritoriality by virtue of sections 1 – 2, Criminal Justice Act 1993 (**CJA**).
- On the basis of the *Criminal Justice Act 1993* and the common law principles, the courts of England and Wales can:

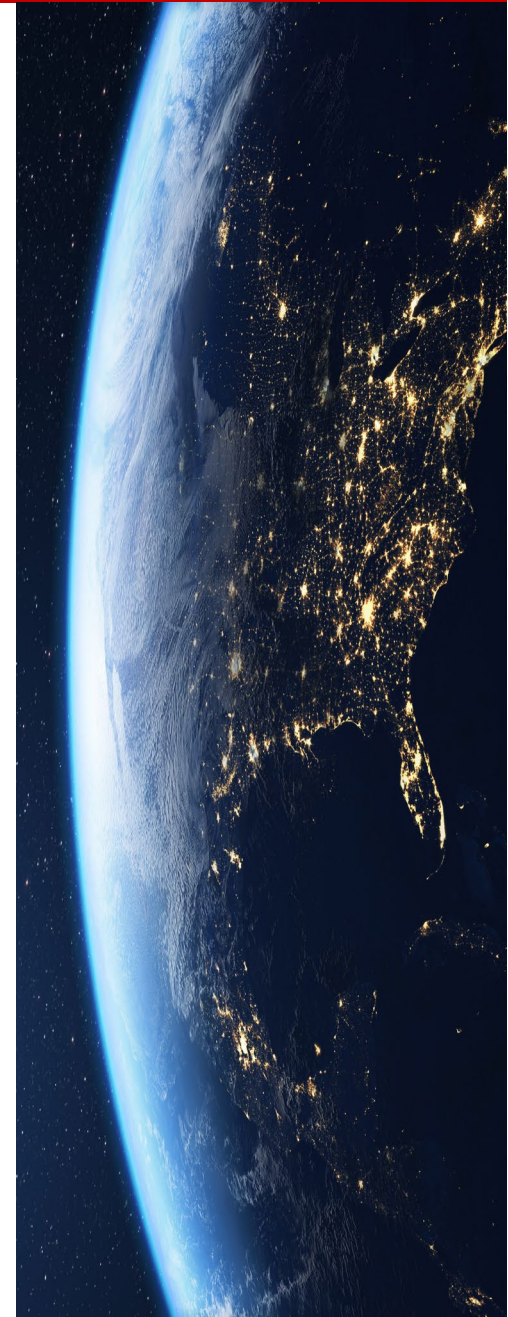
“apply the English criminal law where a substantial measure of the activities constituting a crime take place in England and restrict its application in such circumstances solely in cases where it can seriously be argued on a reasonable view that these activities should, on the basis of international comity, be dealt with by another country.” (*R v Smith (Wallace Duncan) (No. 4)*) [2004] EWCA Crim 631.

Failure to Prevent Fraud

Extra-Territorial Effect of the Act

Jurisdictional scope of the Fraud Act, Theft Act and common law offences

- A person can be guilty of these offences if part of the relevant conduct takes place abroad, provided that a “relevant event” occurs in England and Wales (the **Relevant Event Test**).
- A **Relevant Event** means any act, omission or other event, proof of which is required for conviction of the relevant offence.
- The CJA further specifies that, in relation to the Fraud Act offences of fraud by false representation / failing to disclose information / abuse of position (sections 1 – 4, Fraud Act), a Relevant Event will include (but is not limited to) the occurrence of any gain, loss or risk of loss.

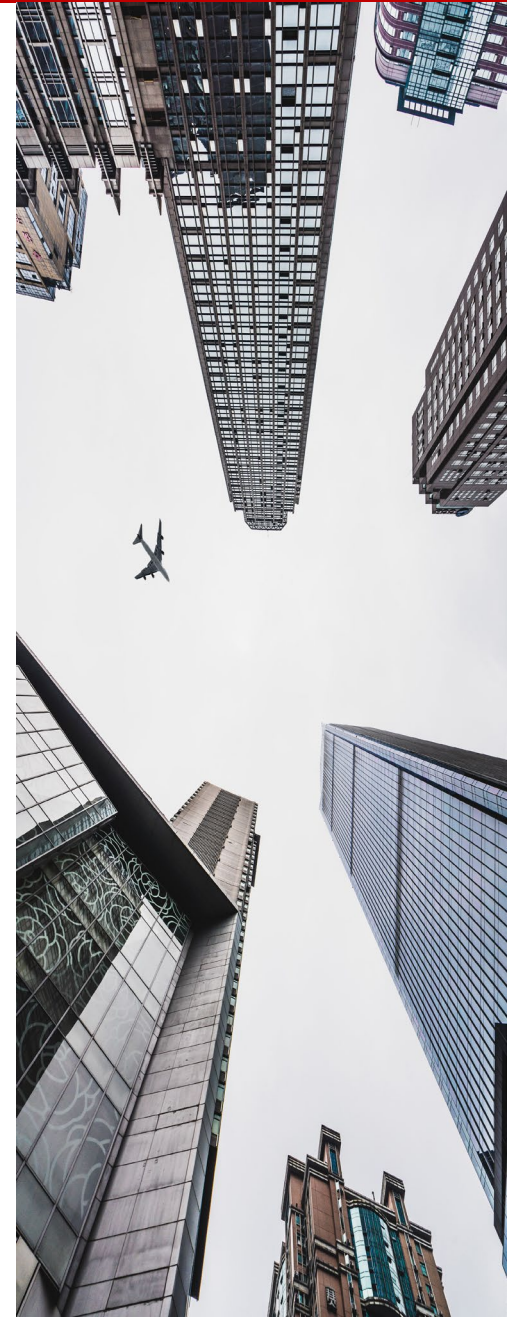


Failure to Prevent Fraud

Extra-Territorial Effect of the Act

Jurisdictional scope of the Companies Act offence of fraudulent trading

- The jurisdictional position is more straight-forward, when compared to other relevant fraud offences.
- This offence is **not** subject to the **Relevant Event Test**.
- It can only be committed in respect of a business which is registered, or carrying out business in, the UK.
- There is a similar offence of “participating in a fraudulent business” which covers sole traders, partnerships, trusts and companies registered overseas under section 9, Fraud Act. That offence is also a relevant fraud offence under the ECCTA and is subject to the Relevant Event Test referred to above.

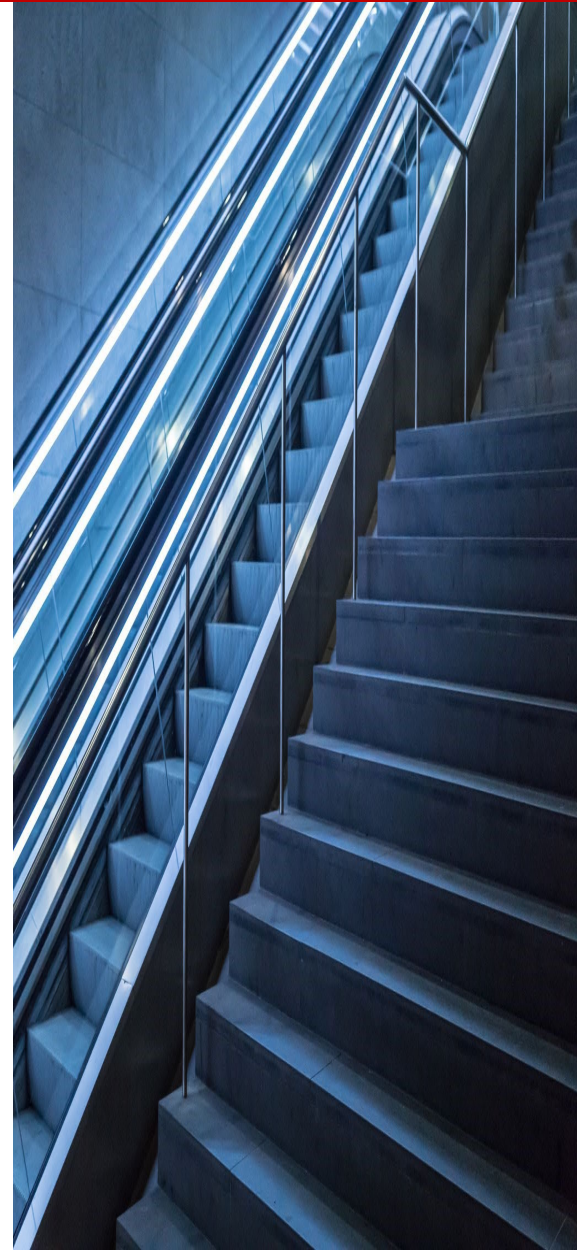


Practical Considerations

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What steps should a business take?

- **Reasonable policies and procedures:** identify and update relevant existing policies or introduce new policies to ensure the new offences are taken into account and to mitigate the fraud risks identified in the risk assessment.
- **Reporting:** ensure appropriate channels are in place for reporting suspicions of fraud.
- **Identification of potential senior managers:** identify which individuals and roles may fall into the definition of “*senior manager*”. Ensure those individuals receive adequate training on fraud risk and applicable policies and procedures and are appropriately monitored.
- **Raising awareness within the company:** provide adequate training to employees to embed fraud policies and procedures and ensure that employees are aware of appropriate channels for reporting suspicions of fraud. Records of this training should be retained.
- **Risk assessments:** carry out and document appropriate risk assessments, identifying relevant fraud risks.
- **Ongoing monitoring:** procedures should be put in place for the ongoing monitoring of fraud risk, compliance with relevant policies and procedures (including the effectiveness of fraud detection processes), and the conduct of individuals. Companies should monitor and review their effectiveness on a regular basis to ensure that necessary improvements are made when required.



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