KEY POINTS

- The UK government has proposed a new corporate failure to prevent fraud offence, similar in structure to the existing failure to prevent bribery offence. It would represent a limited but significant reform of corporate criminal liability.
- The main objective of the new offence is to incentivise improved anti-fraud compliance by making "reasonable procedures" a defence to any charge of failure to prevent fraud.
- The experience of enforcement under the failure to prevent bribery offence casts some doubt over the potential deterrent effect of the new offence.
- Despite overlap with the existing regulatory framework, financial services companies should consider both likely direct and indirect effects of the proposed failure to prevent fraud offence.

Authors Richard Lissack KC and Robin Lööf

Failure to prevent fraud: making up for failure to prosecute?

The UK government has introduced a suite of amendments to the Economic Crime and Corporate Transparency Bill (ECCTB) which, if adopted, would add a new offence of "failure to prevent fraud" by large legal entities to the UK statute book.

Corporate crime specialists Richard Lissack KC and Robin Lööf of Fountain Court Chambers analyse the proposed new offence, its background and context, main features and policy justification. Using the experience of over a decade of the existing failure to prevent bribery regime, they then consider the likely impact of the new failure to prevent fraud offence on business.

INTRODUCTION

There is a widespread popular belief that big business "gets away with" criminal misconduct and that the substantive law is at least partly to blame. In particular, it is a widely held view that the standard basis for attributing criminal liability to legal entities, the so-called "identification doctrine" is too narrow. According to the identification doctrine, a company will be criminally liable (including for fraud) if a person who can be qualified as its "directing mind and will" for the purpose of the activity in question commits an offence with the requisite *mens rea*. However, while there is widespread dissatisfaction with the law of corporate criminal liability and how it has developed, reform has and continues to be hampered by a lack of consensus on how it should be reformed.

There have been years of intense discussion, speculation and debate amongst practitioners, academics and politicians. In an attempt to move the discussion on, in November 2020 the government tasked the Law Commission with coming up with a list of options for reform. The Law Commission presented its "Options Paper" on reforming the law of corporate criminal liability to government in June of last year. The proposed introduction of the failure to prevent fraud offence is the start of the legislative reaction to the Law Commission's conclusions.

The Law Commission's principal recommendation was a reform to the identification doctrine, effectively proposing that the range of individuals whose criminal conduct could be attributed to legal persons, and the circumstances in which it could be so attributed, should be expanded. According to its Economic Crime Plan for 2023 to 2026, published on 30 March 2023, the government is apparently intending to "[l]egislate to make it easier to prosecute corporates for crimes committed by their senior managers by improving the way decision-makers of the corporate are identified by law (identification doctrine) … [as] parliamentary time allows". This more fundamental reform of the law of corporate criminal liability will not be introduced into the Economic Crime and Corporate Transparency Bill (ECCTB).

In relation to expanding the failure to prevent regime, the Law Commission was far from enthusiastic. It took the view that if the failure to prevent regime was to be expanded, such an expansion should be limited to a failure to prevent "core fraud offences". That is the approach adopted by the government in an attempt to address a type of offending which, according to public communications accompanying the proposals, represents 41% of all criminal activity in the UK.

To corporate legal and compliance teams by now very familiar with the failure to prevent bribery regime, the elements of the proposed failure to prevent fraud offence will come as little surprise, although there are a few notable differences.

THE PROPOSED FAILURE TO PREVENT FRAUD OFFENCE

The government's proposal for the failure to prevent fraud offence was contained in amendments to the ECCTB introduced on 11 April during its committee stage in the House of Lords. It would not replace primary corporate liability for fraud offences under the identification doctrine. Rather, the proposed offence would make a corporate entity or partnership (a "relevant body") criminally liable if "a person associated with" it committed one of a list of fraud offences "intending to benefit (whether directly or indirectly)" either the relevant body itself, or "any person to whom, or to whose subsidiary, the associate provides services on behalf of the relevant body". The only available sentence would be a fine, albeit unlimited.

The text exempts from liability any relevant body which is *the* intended victim, and likely also any that is *one of several* intended victims, of the relevant fraud. A relevant body has a defence to a charge of having failed to prevent a fraud if it had in place at the time of the offence "such prevention procedures as it was reasonable in all the circumstances to expect the body to have in place".

There are three main concepts which call for clarification: what is a "relevant body", who qualifies as an associated person, and which fraud offences are in scope.

First, the definition of a "relevant body". Like the failure to prevent bribery offence, failure to prevent fraud would apply to corporate entities and partnerships. However, unlike the failure to prevent bribery regime, failure to prevent fraud would only apply to "large organisations", defined with reference to the same criteria as are used to define "large companies" under the Companies Act 2006, ie those that meet at least two of the following criteria:

- turnover of more than £36m;
- balance sheet total of more than £18m; and
- more than 250 employees.

The choice to limit the application of the failure to prevent fraud offence to large organisations is out of a concern not to burden SMEs with the compliance costs associated with implementing the prevention procedures. It is also broadly right that smaller organisations are more likely to be caught under the general identification doctrine in any event as their directing minds and will are more likely to be directly involved with any criminal conduct on their behalf.

Against that are the arguments that fraud is likely no less prevalent in the SME sector, and, in addition, "reasonable procedures" are intended to be proportionate to the size and nature of a particular business.

In any event, the proposed amendments would give the Secretary of State power to amend the threshold criteria for which relevant bodies are considered "larger organisations", or even remove this limitation to make the offence generally applicable. However, for as long as the "larger organisations" limitation is in place, it can be expected to dovetail with the Companies Act criteria to avoid imposing separate accounting criteria for companies to consider.

Second, who can be an associated person? Although framed somewhat differently, the definition should capture the same wide range of persons as the failure to prevent bribery regime. For these purposes, an associated person is either "an employee, agent or subsidiary of the relevant body", or any person who "otherwise performs services for or on behalf of the body".

Third, which fraud offences are covered? Here the proposal is for a schedule to include the English common law offence of cheating the public revenue (there are additional offences under Scots common law), as well as the following English statutory offences:

- false accounting and false statements by company directors, under the Theft Act 1968;
- fraudulent trading under the Companies Act 2006; and
- fraud, participating in fraudulent business carried on by a sole trader, and obtaining services dishonestly, under the Fraud Act 2006.

It is proposed that the Secretary of State has the power to add further dishonesty and fraud offences to the list of offences covered by the failure to prevent regime.

In accordance with Law Commission recommendations, inchoate offences, ie offences which are complete before a substantive criminal act has been committed, are excluded. This means, significantly, that conspiracy to defraud is not included in the failure to prevent regime (although a legal person can still be guilty of that under ordinary, identification doctrine principles).

In terms of the "reasonable prevention procedures" defence, the proposal is for government to have an obligation to provide guidance, and that the failure to prevent fraud offence could not be brought into effect until such guidance has been issued.

Finally, the jurisdictional reach of the proposed new offence is different to the failure to prevent bribery regime. In the latter, a company that conducts any business in the UK is potentially liable for any bribery committed by an associated person, even if that bribery is unconnected to the company's business in the UK. In the proposed new failure to prevent fraud offence, any relevant body, "wherever incorporated or formed", is potentially liable *but* the triggering offence must be one over which there is UK jurisdiction. This means that there would necessarily be a link between the relevant body's activities in the UK and the basis for its liability for failure to prevent frauds committed for its benefit.

LESSONS LEARNED FROM FAILURE TO PREVENT BRIBERY

The government has not only adopted the broad outline of the failure to prevent bribery offence as a template for the proposed failure to prevent fraud offence, it has also used the practical experience of the operation of the former to guide its expectations for the impact of the latter. Those hoping for a long line of companies being paraded through our courts will likely be disappointed. The government is clear that its ambition is to replicate in the area of corporate fraud the impact of the introduction of the offence of failure to prevent bribery in the area of corporate corruption. The accompanying impact assessment makes it clear that "[the] main benefit of this legislation is the cultural change it is intended to create", it being hoped that "[the] threat of criminal liability will encourage organisations to put fraud prevention measures in place which can reduce fraud".

As readers may be aware, a (possibly the) main impact on business from the introduction of the failure to prevent bribery offence was the upgrading, in some cases creation, of anti-bribery compliance procedures. It is difficult to overstate the cultural shift in corporate compliance culture which resulted from the change in the enforcement risk-calculus brought about by the introduction of the failure to prevent bribery offence. The government hopes for a similar step-change in anti-fraud compliance from the introduction of the failure to prevent fraud offence.

Of course, the change in corporate compliance culture is premised on their being a credible enforcement threat. Here the experience from the operation of the failure to prevent bribery regime is mixed. Regrettably, making it easier to hold companies liable for corrupt conduct in their operations was not accompanied by significant increases in the resources of the law enforcement bodies meant to hold them to account, in

Biog box
Richard Lissack KC and Robin Lööf are barristers practising from Fountain Court Chambers, London. Email: rl@fountaincourt.co.uk and rlo@fountaincourt.co.uk

particular the Serious Fraud Office (SFO). The SFO has only secured two convictions of companies for failing to prevent bribery (Sweett Group in 2016 and Glencore earlier this year). The Crown Prosecution Service (CPS), for its part, in 2018 decided to spend precious resources prosecuting a by then dormant, small interior designs company which unsuccessfully relied on the adequate procedures defence. More recently, the CPS secured guilty pleas from three companies for failing to prevent bribery in obtaining supply contracts from Coca-Cola.

The bulk of corporate enforcement under the failure to prevent bribery offence has been by way of deferred prosecution agreements (DPAs), an instrument which was introduced by the Crime and Courts Act 2013. Since DPAs became available in early 2014, nine companies have avoided convictions by settling SFO investigations into alleged criminal conduct by agreeing to pay often significant monetary penalties, disgorge profits, and improve their compliance procedures. Most of these settlements have involved allegations of failures to prevent bribery.

There has been sustained criticism of the SFO's emphasis on DPAs. Anti-corruption campaigners criticise these settlements for being a way for companies to negotiate their way out of criminal liability in opaque circumstances. While DPAs are subject to judicial scrutiny, the parties having to convince a judge (often a senior judge) that the arrangement is in the public interest, there are no known examples of a court refusing to endorse a proposed DPA.

In addition, the SFO has been criticised for becoming lazy, using DPAs as an easy way to extract significant monetary penalties from corporate suspects and avoiding the difficulties associated with bringing prosecutions.

Clearly, the threat of enforcement, even by DPA, is a weighty incentive to strengthen corporate compliance, but this incentive is premised on a credible threat of ultimate prosecution. Here the problem is that this threat appears to have receded. The past few years have seen a series of failed SFO prosecutions of individuals on whose alleged corrupt conduct DPAs have been premised. In fact, the SFO has only secured one conviction of an individual in a case preceded by a corporate DPA. It is an open question whether this unimpressive prosecutorial record is having an impact on the risk-calculus upon which the continued commitment to corporate compliance rests.

Against this background, according to its impact assessment the government does not expect there to be many prosecutions for failures to prevent fraud, although it is said that the prevalence of fraud is likely to make prosecutions somewhat more common than they have been for failure to prevent bribery. However, the proposed amendments (of course) include an amendment to the Crime and Courts Act 2013 to include failure to prevent fraud among the offences which can be resolved by DPA. The government appears content to replicate the experience of the failure to prevent bribery regime, expecting the majority of investigations into failures to prevent fraud to be resolved by means of a DPA.

There will continue to be disagreement on whether this transactional model of criminal enforcement is a good thing. From a purely pragmatic perspective, undoubtedly the introduction of failure to prevent bribery has significantly improved corporate compliance. What is an open question is whether the lack of investment in enforcement of economic and financial offending and the UK's lacklustre prosecution record has blunted that impact. If it has, the government may be over-optimistic to expect a corresponding improvement in anti-fraud compliance from the introduction of failure to prevent fraud.

LIKELY IMPACT ON THE FINANCIAL SERVICES SECTOR

The regulated financial sector is not the primary target of the new offence. It already has an obligation to prevent financial crime which, under SYSC (Senior Management Arrangements, Systems and Controls) 3.2.6. R and FCG (Financial Crime Guide) 4, includes fraud-prevention. Indeed, the Law Commission noted in its Options Paper that one of the difficulties with generalising failure to prevent across economic and financial crime was that it would overlap with existing regulatory regimes.

It would appear potentially unnecessary and unwarranted to shift from a regulatory to a criminal enforcement approach in the financial services industry. Even so, financial services companies would be well-advised to review their anti-fraud procedures in light of the introduction of failure to prevent fraud. For example, it is not impossible that issues like the miss-selling of PPI could in future lead to criminal investigation. In this context, it is worth remembering that the first ever DPA was entered into by a bank in relation to allegations of failure to prevent bribery.

Additionally, expansion of corporate criminal liability for fraudulent behaviour will logically lead to an increase in corporate revenue which could potentially represent the proceeds of criminal conduct. The financial services sector therefore needs to be aware of the knock-on effects of the introduction of the failure to prevent fraud offence on their anti-money laundering procedures.

This leads us to the final comment on the government's proposed amendments to the ECCTB: In an unremarkable and poorly sign-posted sub-section, it is proposed that the Secretary of State has the power to extend the failure to prevent regime to the principal money laundering offences under the Proceeds of Crime Act 2002. If used, there is no doubt that this reform would result in radical overlap with the core of the existing regulatory compliance regime. However, the fact that this extension is contemplated evidences a potential willingness to criminalise failures within the financial sector to live up to their regulatory obligations. ■

Further Reading:

- Reforming corporate criminal liability: a missed opportunity to modernise the law (2023) 1 JIBFL 30.
- Corporate criminal liability: identifying the "directing mind and will" (2020) 7 JIBFL 478.
- Lexis+® UK: Corporate crime: What to expect from the new failure to prevent fraud offence.