24 January 2011

Our ref: ICAEW Rep 09/11

Your ref: CP195

The Law Commission
11 Tothill Street
London SW1H 9LJ

Dear Sirs

CORPORATE CRIMINAL LIABILITY

The ICAEW is pleased to respond to your request for comments on *Criminal Liability in a Regulatory Context*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

CORPORATE CRIMINAL LIABILITY

Memorandum of comment submitted in January 2011 by the ICAEW, in response to the Law Commission's consultation paper Criminal Liability in a Regulatory Context published in August 2010

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INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Criminal Liability in a Regulatory Context* published by the Law Commission.

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation and disciplinary oversight of its members is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries. We also provide rigorously applied ethical and other professional standards whether those members work in practice, in business or in Government or the voluntary sector. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. Using these skills, they are frequently employed in functions which design, assess or operate systems for risk control and regulatory compliance, at Board or general management level in business, or by advisory or audit functions in public practice. We ensure these skills are constantly developed, recognised and valued.

4. ICAEW has for many years been concerned with the growth and extent of the regulatory burdens imposed on businesses of all types and sizes. We welcome this project, as one of a number of initiatives that should, taken together, reduce those burdens and make them more proportionately borne by the businesses most likely to seriously damage the public interest in non-compliance.

MAJOR POINTS

Support for the initiative

5. This project has the wholehearted support of ICAEW. As noted by the Law Commission, the criminal statute law has grown so fast and to such an extent that consistency and logic are almost impossible to maintain, particularly without common principles on which new legislation is prepared. This has a number of potential dangers which (though difficult to measure) are, we believe, already causing unnecessary harm to the rule of law and the operation of commerce and other private functions in the UK.

6. There are a number of ways in which we wonder if the project could be further improved, without adding unnecessarily to the extent and nature of the work to be done. For example through:

- More explicit coverage of all corporate and other business crime, not just regulatory crime (including in the title of the project). The text of the consultation in fact does this, through the use in discussion of a number of generally applicable crimes, such as bribery. The conclusions and recommendations made by the Commission should not exclude such activities which should be treated consistently, whether or not the crimes are imposed in a regulatory or general context.

- More consideration of the need to promote good governance and management of companies and other businesses. In law and in principle the whole management of companies is, and should be, delegated by the owners (shareholders) to the Board of Directors who thus have the core responsibility for the ethical and legal behaviour of all its employees and other agents. This responsibility could be undermined by enabling Boards (and the natural persons who are members of Boards) to escape their responsibilities by

the inappropriately wide application of the “identification” or similar doctrines, This could reduce the effectiveness of control procedures set up and maintained by companies. It could also damage the governance of companies, by giving the impression that the general theory of corporate governance is inapplicable in the area of the control of legal risk arising from criminal activity.

- Explicit consideration of the desirablity of promoting equivalent standards of behaviour under the law by differently constituted businesses. Criminal activities carried out by, or within, the business of a partnership, a sole trader with employees, a mutual society or any other business should be treated with an equivalent degree of severity and on a similar basis to one carried out by a company. For example, some sole traders can grow into quite substantial businesses, with similar issues of the need for the proprietor to introduce controls or systems as is the case with small or medium sized companies. For any business, there is a need to ensure that ultimate responsibility lies at the appropriate level of either the owner(s) or the most senior level to which the owners have delegated responsibility for the management of their business/company.

- Consideration of how changes in the number and detail of regulatory criminal offences might affect other regulatory rules and enforcement provisions. It is our experience and belief that the introduction of an explicit criminal offence where there has not previously been one, together with a belief that it will be enforced, concentrates the mind of Boards of Directors and other management and governing bodies, in a way that is difficult to duplicate in any other way. If a reduction in regulatory crimes leads to a need for even more alternative regulations and regulatory sanctions to try and compensate, this will add considerably to the costs borne by business. It may also lead to a strengthening of the adverse effect that high costs will be borne by compliant businesses, without effective sanctions being applied to those which do not.

RESPONSES TO SPECIFIC QUESTIONS AND PROPOSALS

General Principles: The Limits of Criminalisation

PROPOSAL 1: The criminal law should only be employed to deal with wrongdoers who deserve the stigma associated with criminal conviction because they have engaged in seriously reprehensible conduct. It should not be used as the primary means of promoting regulatory objectives.

PROPOSAL 2: Harm done or risked should be regarded as serious enough to warrant criminalisation only if,

> ***(a) in some circumstances (not just extreme circumstances), an individual could justifiably be sent to prison for a first offence, or***
>
> ***(b) an unlimited fine is necessary to address the seriousness of the wrongdoing in issue, and its consequences (putting aside factors such as whether the individual has previous convictions for other offences, and so on).***

These two proposals are drafted in terms of “wrongdoers” and “individuals” in a way that suggests that they are aimed at natural persons, rather than businesses. In that context we agree with the proposals. However, more consideration should be given to the application of these provisions in relation to regulatory and business crime.

The worst of regulatory or other legal provisions are those that are complex, onerous and expensive as applied by honest and conscientious businesses, but are ignored with impunity by those which are not. Such provisions are ineffective in the regulatory protection that they are aimed at providing, while simultaneously giving an unfair competitive advantage to those who are prepared to ignore them. Nevertheless, regulatory provisions can be difficult and expensive to

enforce and despite the improvements introduced since the publication of Professor Macrory's Report and the passing of the Regulatory Enforcement and Sanctions Act we do not anticipate a fast progression to universally logical, consistent and very firm non-criminal enforcement of regulatory requirements. For this reason, we would not support the wholesale removal of criminal offences, which have been put in place to back non-criminal enforcement mechanisms, nor necessarily as widespread a reduction of them as may be implied by this proposal.

We do not think that the deterrence effect of the criminal law can be stated in the simple economic terms of likelihood of conviction times the severity of the punishment. Rather, we would agree with the statement made in paragraph 3.8 and implied elsewhere that one of the important effects of a criminal conviction is to create significant stigma. This is certainly the approach we would take to the application of our own professional disciplinary oversight, with a criminal conviction in a professional context leading to an automatic assumption of professional ethical misconduct, with the ultimate sanction of the removal of professional status and livelihood. We believe that this effect should be reinforced by the courts, with fines set at a level which reinforces the stigma by ensuring that it is reflected by the severity of the punishment imposed. Professor Black's formulation set out in paragraph A59 of the consultation, of fines being set in terms of a function of the benefit to the regulated firm of non-compliance and the probability of detection should be an absolute floor to the assessment of fines, not just an average. We acknowledge that this can sometimes lead to an inability to pay, followed by the insolvency of an individual or a company, but this is one of the outcomes anticipated by insolvency law and is not inappropriate in the circumstances.

If persistent and material non-compliance with regulatory requirements is not considered serious, then the appropriate response is to remove the regulatory provisions in their entirety, not just to decriminalise them.

PROPOSAL 3: Low-level criminal offences should be repealed in any instance where the introduction of a civil penalty (or equivalent measure) is likely to do as much to secure appropriate levels of punishment and deterrence.

We agree with the principle of this proposal. However, in cases where there is no appropriate regulatory body in place, with the right and duty to impose appropriate civil penalties or other regulatory sanctions, it may be necessary to retain the criminal sanctions. We understand this to have been the case with some animal welfare requirements.

General Principles: Avoiding Pointless Overlaps between Offences

PROPOSAL 4: The criminal law should not be used to deal with inchoate offending when it is covered by the existing law governing conspiracy, attempt, and assisting or encouraging crime.

PROPOSAL 5: The criminal law should not be used to deal with fraud when the conduct in question is covered by the Fraud Act 2006.

We agree with these two proposals, which deal with two specific areas of pointless overlap between offences. However, there should also be a general duty on the drafters of legislation, and Parliament itself, to avoid and remove any other areas of pointless overlap. Besides the unnecessary complexity introduced by such separately drafted provisions, they also inevitably tend to result in unintended consequences, inconsistent outcomes and penalties and doubtful justice, as noted in a number of instances in the consultation document.

This should also apply to the inappropriate placement of offences, identified in paragraphs 3.129 to 3.135 of the Consultation Document.

However, please see our comment in paragraph 6 above, on the desirability of criminal offences to back up and reinforce regulatory provisions. This could be done, perhaps, by specifically providing

in Statute that certain offences committed in a regulatory or business context should be treated in accordance with the provisions of the Fraud Act.

General Principles: Structure and Process

PROPOSAL 6: Criminal offences should, along with the civil measures that accompany them, form a hierarchy of seriousness.

We agree with this proposal. This should be backed by the assumption that criminal fines or confiscations will always be levied at a rate higher than would be the case with the equivalent civil penalties.

PROPOSAL 7: More use should be made of process fairness to increase confidence in the criminal justice system. Duties on regulators formally to warn potential offenders that they are subject to liability should be supplemented by granting the courts power to stay proceedings until non-criminal regulatory steps have been taken first, in appropriate cases.

We agree with this proposal.

PROPOSAL 8: Criminal offences should be created and (other than in relation to minor details) amended only through primary legislation.

We agree that criminal offences should only be created or made more onerous through primary legislation.

We are concerned that the Law Commission, in paragraph 3.146 and footnote 106, state that they do not think it appropriate for them to consider what the interpretation of the phrase “other than in relation to minor details” may turn out to mean in practice. The Commission have been asked to introduce rationality and principle into this element of the law, and regulatory authorities and agencies may take as partial and inconsistent an approach to the interpretation of this phrase as they currently do to the interpretation of the words “necessary” or “desirable”.

However, the drafting of legislation is difficult and we have come across frequent cases where the introduction of regulatory provisions has had serious, onerous and wholly undesirable unintended consequences, especially given the complexity of many regulatory provisions and the speed at which they are frequently introduced. Such counter-productive provisions should be able to be removed quickly and simply (after the appropriate due process) by secondary legislation.

Rather than formulating the exemption in terms of “minor details”, we suggest it is formulated in terms of:

- changes which reduce or avoid inappropriate or unnecessary regulatory burdens; or
- correct unintended consequences not anticipated by Parliament.

The inappropriate or unnecessary regulatory burdens would, implicitly or explicitly, include those costs and other burdens introduced through unclear or obscure wording.

PROPOSAL 9: A regulatory scheme that makes provision for the imposition of any civil penalty, or equivalent measure, must also provide for unfettered recourse to the courts to challenge the imposition of that measure, by way of rehearing or appeal on a point of law.

We strongly support this proposal. The lack of this right undermines controls over the fair and just application of their responsibilities by regulators.

General Principles: Fault in Offences Supporting a Regulatory Structure

PROPOSAL 10: Fault elements in criminal offences that are concerned with unjustified risk-taking should be proportionate. This means that the more remote the conduct criminalised from harm done, and the less grave that harm, the more compelling the case for higher-level fault requirements such as dishonesty, intention, knowledge or recklessness.

We agree with this proposal.

PROPOSAL 11: In relation to wrongdoing bearing on the simple provision of (or failure to provide) information, individuals should not be subject to criminal proceedings – even if they may still face civil penalties – unless their wrongdoing was knowing or reckless.

We agree with this proposal.

The text of the consultation document suggests that strict liability offences for the failure to provide information should not be introduced into any new legislation, but we believe that it should also be removed from those statutes where it currently applies. We are particularly aware of the anomalies that apply in matters of taxation, in that there is a strict liability in the provisions relating to VAT, but not for other taxes.

PROPOSAL 12: The Ministry of Justice, in collaboration with other departments and agencies, should seek to ensure not only that proportionate fault elements are an essential part of criminal offences created to support regulatory aims, but also that there is consistency and clarity in the use of such elements when the offence in question is to be used by departments and agencies for a similar purpose.

We agree with this proposal. Previously introduced inconsistencies and lack of clarity should also be removed, as soon as opportunity presents.

Doctrines of Criminal Liability Applicable to Businesses - The doctrine of identification

PROPOSAL 13: Legislation should include specific provisions in criminal offences to indicate the basis on which companies may be found liable, but in the absence of such provisions, the courts should treat the question of how corporate criminal liability may be established as a matter of statutory interpretation. We encourage the courts not to presume that the identification doctrine applies when interpreting the scope of criminal offences applicable to companies.

The more that different criminal provisions can be drafted consistently and in the same terms, and interpreted by the Courts on a consistent basis, the more efficiently and reliably appropriate controls and procedures can be introduced and maintained by businesses for compliance with them all. For this reason, we would strongly prefer there to be a single basis on which criminal liability may be established for companies and other businesses, rather than leaving this to be drafted specifically for different statures, and left as a matter for statutory interpretation in all other cases.

We understand the difference in principle between crimes which are committed for and on behalf of a business (such as bribery and some frauds), crimes which are committed by individuals for their own profit but using their employer's time and resources (such as producing indecent images of children) and crimes which occur due to an aggregation of gross negligence (such as corporate manslaughter). But we believe that the appropriate response to all such areas of risk of misconduct, which are serious enough to require a business offence to be introduced, is the same for all businesses – that is by appropriate standards of governance and internal control.

Appropriate wording has already been formulated in Statute in the Bribery Act, which would also be appropriate (with appropriate modifications, such as removing the necessary extraterritorial provisions, and application to agents as well as employees, included in that Act) to other business crimes. Similarly, the principles based guidance on the appropriate procedures which would represent a defence to this criminal charge of corporate bribery offences would apply equally well to other business crimes.

We believe that the Courts should not just be encouraged to presume that the identification doctrine does not apply to business crimes, but that specific legislation should be introduced to negate this element of the common law. The continuation of this doctrine continues a wholly unjustified divergence in the treatment of equivalently serious offences, in accordance with the size or constitution of the body within which they were committed. This is not appropriate. Rather, we consider that a uniform approach should be taken, with an initial presumption that a corporate offence of committing, or of failing to prevent, the underlying crime would apply in all these circumstances, though strongly modified by a due diligence offence which is appropriately applied with less diligence required for more remote and less harmful possible crimes.

- A general defence of due diligence

PROPOSAL 14: The courts should be given a power to apply a due diligence defence to any statutory offence that does not require proof that the defendant was at fault in engaging in the wrongful conduct. The burden of proof should be on the defendant to establish the defence.

PROPOSAL 15: If proposal 14 is accepted, the defence of due diligence should take the form of showing that due diligence was exercised in all the circumstances to avoid the commission of the offence.

However, we recognise that consultees may prefer this defence to have the same wording and to impose the same standards as the most commonly encountered form of the defence. Accordingly, we ask the following questions:

The circumstance and terms of the underlying offences will be very different in different circumstances, but we would strongly prefer the due diligence defence to be worded in the same way for all corporate and other business offences. Businesses should not be asked to apply different types or principles of governance or control in relation to different criminal offences, though the degree and standards to which those controls should be applied will vary according to the likelihood of occurrence and the harm or seriousness of the behaviour concerned. That would result in a compliance nightmare, with a watching brief needing to be kept over possible changes to the large and increasing number of potential business crimes, to ensure that the differing terms of all of them had been complied with.

QUESTION 1: Were it to be introduced, should the due diligence defence take the stricter form already found in some statutes, namely, did the defendant take all reasonable precautions and exercise all due diligence to avoid commission of the offence?

The wording of a due diligence defence in such absolute terms as <u>all</u> reasonable precautions and <u>all</u> due diligence implies a counsel of perfection that is unlikely to be achieved in practice. This is unhelpful in the context of running a business.

Our preference would be for the wording to avoid the term “due diligence” at all, in favour of the wording of the defence recently introduced by the Bribery Act 2010 of having “adequate procedures” for the prevention of the relevant corporate offence. This implies a continuing requirement for internal control procedures sufficient to give reasonable assurance that the criminal law had been complied with, while “due diligence” is sometimes used in the context of a single exercise of examination and confirmation, for example in the context of a corporate take-over.

Further, the “adequate procedures” defence in the Bribery Act is required to be backed by Guidance published by the Secretary of State, which is expected to provide useful assistance in judging what levels of assurance will be “adequate”. The final version of this Guidance is not yet available, but the consultation draft published by the Ministry of Justice includes a summary of the type of internal controls that would be suitable for businesses in preventing the commission of bribery offences. These procedures would be equally relevant in preventing any other business crime.

We have responded to the Ministry of Justice consultation on guidance on “adequate procedures” suggesting a number of changes to make the terms of the Guidance easier to apply and less onerous, particularly for small businesses. However, this does not take away from our belief that this is an appropriate way forward, not just in relation to bribery, but for other business crimes as well.

QUESTION 2: If the power to apply a due diligence defence is introduced, should Parliament prevent or restrict its application to certain statutes, and if so which statutes?

We believe that a due diligence defence should apply to all criminal offences of companies or other business entities.

Paragraph 1.80 of the consultation document comments that in some contexts, such as road traffic offences, the general application of a due diligence defence may lead to long and costly, albeit vain, attempts to avoid a conviction by defendants. However, if this defence is available to businesses but not to individually culpable drivers, and fines are levied at an appropriately high level, we do not think that this would be a problem. If a company or other business does have appropriate procedures to prevent road traffic offences being committed on its behalf, taking into account the likelihood and severity of such offences, then we think that such a defence should be available to it.

If the availability of a due diligence defence is limited to companies and other business entities, we do not think that the difficulties expressed by the Commission in paragraph 2.24 of the consultation (that the overlap between regulatory offences and other public interest offences would make this too complicated, using Anti-Social Behaviour Orders as an example) would be a problem.

- The consent and connivance doctrine

PROPOSAL 16: When it is appropriate to provide that individual directors (or equivalent officers) can themselves be liable for an offence committed by their company, on the basis that they consented or connived at the company’s commission of that offence, the provision in question should not be extended to include instances in which the company’s offence is attributable to neglect on the part of an individual director or equivalent person.

We agree with this proposal.

QUESTION 3: When a company is proved to have committed an offence, might it be appropriate in some circumstances to provide that an individual director (or equivalent officer) can be liable for the separate offence of ‘negligently failing to prevent’ that offence?

We would be content with a corporate offence of negligently failing to prevent the commission of a criminal offence (as has been done with the Bribery Act) but on balance we would expect the “consent or connivance” offence to be sufficient in relation to individual directors or equivalent officers or proprietors. If this was considered by Parliament to be sufficient in the context of the very serious issue of bribery, we fail to see why a stronger formulation should be considered necessary in other contexts. The Board of Directors should have collegiate responsibility for the

actions of the company, and we would not think it appropriate for individual directors to be targeted for the negligence that should be attributable to the company as a whole.

If individual directors are culpable otherwise than through negligence, and the consent or connivance provisions are not sufficient, it would appear likely that an individual director would be liable either for personally committing the offence, or else through one of the inchoate offences. If not, then the corporate offence would be the main punishment of the business (together with prosecution of individuals directly committing the offence) and if fines are set at an appropriate level, the shareholders or other proprietors will have reason to take action for any negligence, as appropriate.

- The delegation doctrine

QUESTION 4: Should the doctrine of delegation be abolished, and replaced by an offence of failing to prevent an offence being committed by someone to whom the running of the business had been delegated?

We agree that the doctrine of delegation should be abolished. We think it sufficient for the "failure to prevent" offence to apply to corporates or other business entities, with the "consent or connivance" offence to be committed by directors or other officers.

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