Ministry of Justice
102 Petty France
London
SW1H 9AJ

By email: corpcrimliabilityc@justice.gsi.gov.uk

24 March 2017

Dear Sirs,

Re: BVCA response to call for evidence on corporate liability for economic crime

This response is submitted on behalf of the British Private Equity and Venture Capital Association ("BVCA"). The BVCA is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers and investors. Our members have invested over £27 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 385,000 people and 84% of UK investments in 2015 were directed at small and medium-sized businesses.

Executive summary

- We recognise the serious impact economic crime may have on individuals, businesses and markets more generally but we do not believe that the case for reform (beyond the existing measures for bribery and the upcoming facilitation of tax evasion corporate offence) has been made out.

- The practical implications of each of the potential options for reform would require careful consideration by specific reference to each of the predicate offences. To illustrate why we do not believe that there is a case for reform, we have set out some of the areas of uncertainty or difficulty that may arise in relation to each of the proposed options and why we believe the existing tools and legislative framework are adequate to address, and are proportionate to, the risks posed by economic crime in the context of the current regime.

- Given the current climate, there is a genuine concern that reform could have a negative impact on investment in the UK, particularly if it were not implemented appropriately and proportionately. In particular:

    - we do not think it would be appropriate for any new form of corporate liability to have extraterritorial reach; and

    - we are concerned that broadening the scope of corporate liability for economic crime such that:

        - a parent company or investor could be directly liable for the actions of its subsidiary or portfolio company will lead to a lack of investment and professionalism in the UK; and

- directors, managers and investment professionals are subjected to an increased level of personal liability or risk will lead to a flight of talent in the UK.

Our approach to this response

There are a number of key themes arising from the call for evidence and a number of these key themes cut across several questions. We recognise that not all of the questions raised in the call for evidence are aimed at the private sector. We have limited our response to those issues that specifically affect private equity and venture capital firms, and the UK-based companies in which these firms invest, and have sought to identify the key themes and questions which we believe require further careful consideration in that context before any steps for reform are taken.

The case for reform

We recognise the serious impact economic crime may have on individuals, businesses and markets more generally. As such, it is important that measures exist to deter individuals from committing such crimes. Business is a key stakeholder in the fight against economic crime and it has an important role to play in preventing such crimes from being carried out in its name. There are, however, a number of ways this may be achieved, and what is appropriate should be considered by reference to all the circumstances – central to this question is the perceived level of risk that economic crimes, perpetrated on behalf of businesses, are not and cannot be properly addressed by current means.

The materials supporting the call for evidence do not substantiate or analyse this risk. We believe it is essential to do so before any proposals for reform can be properly evaluated. Whether extending the potential criminal liability of companies is a proportionate and effective response – particularly given the additional compliance burden and related costs that go, hand in hand, with any increased risk of prosecution – depends on the risks posed by economic crime in the context of the current regime.

We recognise, in recent years, some high profile matters may well have dented the public's trust in business. But do these cases justify sweeping reforms that could significantly increase the risks, and therefore compliance costs and resources, for all UK businesses, including small and medium-sized enterprises? The cases referred to in the call for evidence arose in the financial services sector. In response, the financial regulator has imposed significant fines on a number of institutions. And the control environment within those institutions remains subject to the ongoing oversight and scrutiny of the FCA. It is difficult to see how a criminal prosecution of those entities would have had a greater impact on those organisations and the market generally than the regulatory response.

We note this call for evidence follows changes in corporate criminal liability introduced in the UK Bribery Act and the proposed new offence of failing to prevent the facilitation of tax evasion. But each type of predicate offence is different. The fact that a need for reform was identified in relation to bribery and tax evasion should have little bearing on whether the case for reform is made out here. Rather, the question should be considered by reference to the specific offences any reform is designed to address.

The full scope of the term 'economic crime' as used in the call for evidence is unclear. However, we note that, in the context of a potential new failure to prevent type offence, this list is said to likely comprise of:

- the common law offence of conspiracy to defraud;
- the offences at section 1 of the Fraud Act 2006;
- the offence of false accounting at section 17 of the Theft Act 1986; and
- the money-laundering offences at sections 327 to 333 of the Proceeds of Crime Act 2002.

And secondary and inchoate offences may also, possibly, be covered in the definition of economic crime.

There are already a number of tools available to the authorities to address these offences if they occur within business. These include:

- regulation and enforcement in the financial services industry, requiring financial institutions to put in place extensive controls to monitor for and prevent financial crime;
- civil recovery proceedings under the Proceeds of Crime Act, which allow prosecutors to strip companies of any benefits they may have received as a result of the unlawful conduct of any party; and
- the prosecution of individuals.

For bribery and corruption and the facilitation of tax evasion, the economic harm was clearly identified such that the desire to go further than these measures could be more readily understood. For other types of economic crime, however, we do not believe that the economic harm has been clearly identified.

The practical implications of each of the proposed options for reform would require careful consideration by specific reference to each of the predicate offences. Simply adopting wholesale a model used elsewhere (such as strict vicarious liability) or in relation to other offences (such as the failure to prevent model) could lead to unintended consequences.

To further illustrate why we do not believe that there is a case for reform, we set out below some of the areas of uncertainty or difficulty that may arise in relation to each of the proposed options for reform and why we believe the existing tools and legislative framework are adequate to address, and are proportionate to, the risks posed by economic crime in the context of the current regime.

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)

Under the current law, a company may be held liable for economic crimes committed within the organisation if at least one of the directors or senior officers who carry out management functions and speak and act as the company has the relevant criminal intent.

There is currently no exhaustive list of functions making up the 'directing mind and will' of a company. To determine which officers fall within this definition, the company's structure and constitution have to be considered, as do the day-to-day actions and responsibilities of each officer in question. It is ultimately a question of fact in each case. That said, companies and their advisors can look to precedent to help evaluate the likelihood of any individual making up the directing mind and will of the company.

For companies facing criminal prosecution, this is important. Companies can only, properly, assess the case against them and make plea and other settlement decisions if there is a degree of certainty over how the courts will determine which individuals make up the directing mind and will of the company.

Senior prosecutors have stated that the current law renders too narrow a definition of the directing mind and will, particularly in the context of large companies. This, they say, leads to challenges in prosecuting large companies where management structures may insulate the narrow corporate centre from involvement in or knowledge of the misconduct. If it is proposed that the scope of who might be regarded as the directing mind and will of a company is broadened, exactly how would this be done and who would it cover? If the scope is broadened too wide, this would effectively create a form of vicarious liability which would be inappropriate in a criminal context.

Any formulation to broaden the scope of the directing mind and will must be capable of being applied to the myriad of different kinds and sizes of corporate entities that operate in the UK. The challenge here would be to draft a clear formulation, or set of factors, that works in all contexts, and that provides certainty to companies over the identity of their directing minds. A lack of certainty is bad for business and law enforcement alike. Making it harder for companies and prosecutors to be sure of the case against the company could well lead to longer investigations, more contested trials and greater costs for all involved.

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?

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

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

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 model?

Question 11: If your answer to question 10 is in the affirmative, would the list of offences listed on page 22, coupled with a facility to add to the list by secondary legislation, be appropriate for an initial scope of the new offence? Are there any other offences that you think should be included within the scope of any new offence?

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?

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

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?

For convenience, we refer to options 2, 3 and 4 together as the 'corporate offences'. There are various common issues that cut across the three corporate offences and which require careful consideration when weighing up which, if any, of these options would be appropriate were reform to be pursued.

Strict (vicarious) liability: a comparison with the US

Before considering the common issues cutting across the corporate offences, we believe it is necessary to address the comparison made between option 2 and the US regime.

The call for evidence notes option 2 is akin to the US model for attributing liability to companies in the criminal context. This may be the case at a basic level. However, it is important to keep in mind the US model has developed over more than a century's worth of jurisprudence.

Broadly, federal courts in the US continue to rely upon the theory of vicarious liability propounded by the Supreme Court in 1909 (*N.Y. Cent. & Hudson River R.R. Co. v. United States*), which provides that a corporation can be held vicariously liable for the acts of any employee/agent if that individual:

1. acted within the scope and nature of his/her employment;
2. acted, at least in part, to benefit the corporation; and

3. the act and intent can be imputed to the corporation – mainly through the doctrines of 'collective knowledge' or 'wilful blindness'.

However, there is a significant amount of case law interpreting and expounding upon these fundamental requirements. Vicarious liability in the US, whilst broad, is not entirely unbounded and it is not simply based on the fact that a principal/agent relationship exists between the company and the individual wrongdoer.

Furthermore, the US model does not necessarily incentivise improved corporate compliance – under the US approach, having a good compliance program is, at best, a factor prosecutors will look at when exercising their discretion as to whether or not to prosecute; it does not, however, provide a real shield to prosecution.

The above should be borne in mind when considering the comments that follow.

Scope of offence: for whose actions would the company be liable?

Each of the corporate offences imposes liability on the company for the wrongdoing of individuals. However, it is unclear which individuals fall within scope. In particular, the extent to which companies would be liable for the actions of third parties needs clarification.

For example, option 2 refers to the actions of employees, agents and representatives. However it is unclear how widely each of the concepts of agent and representative would be drawn.

Many third parties who act on a company's behalf are independent. The companies that engage them may be able to exercise some leverage or influence, depending on the nature of the commercial relationship, but leverage or influence is very different from control. Often companies have only very limited control over third party agents and the agent's employees. In considering for whose wrongdoing a company might be liable under any of the corporate offences, it is important to recognise this commercial reality.

Option 3 provides even less clarity. It refers to the conduct of those 'pursuing the company's business objectives', while option 4 seems to suggest that, provided the offence occurred because of a failure of management, then conduct by *any* wrong-doer is caught.

If drafted as widely as they appear, the corporate offences could catch scenarios in which a company would have no realistic opportunity to exercise control and prevent the predicate offence from being committed. For example, those 'pursuing the company's business objectives' could (without further clarification) include employees of parties providing supplies to the company or other parties who are indirectly associated with the company (such as subcontractors further down the chain). Depending on the scope of predicate offences, this potentially creates a large number of scenarios where companies may face strict liability for offences committed by parties that may only be indirectly or very loosely related to them. This risk is magnified if the corporate offences cover inchoate offences or secondary liability.

If any of the corporate offences were adopted and were drafted as widely as is suggested in the call for evidence, many companies will effectively be forced to become *de facto* regulators of all parties associated with them – thereby creating a huge burden on the company. At the very least, we would suggest that a clearly defined and narrow limit be placed on the parties for whom the company could be found liable, and that this limit ought to be set out in statute rather than in guidance alone. In addition, guidance at an early stage on what specific relationships would or would not fall within the scope of any corporate offence, if adopted, would be crucial.

The UK Bribery Act deals with the issue of third parties through the definition of associated person – i.e. any third party performing services for or on behalf of the company. But this concept of associated person must also be read in the context of the overall section 7 offence under which the company is only liable if the associated person was paying a bribe to secure or retain business for the company. This creates a necessary filter limiting the scope for companies to be found liable to persons acting for the company's benefit and excluding those who are acting only tangentially on the company's behalf. Any corporate offence for other economic crimes ought to be similarly restricted.

Scope of offence: acts done in 'furtherance of the company's business'

We agree that any new offence should not be used to hold companies criminally liable for acts or omissions which have no connection to the company. However, the proposal to link the offence to acts done in 'furtherance of the business objectives of the company in question' is unclear.

As proposed, the corporate offences may capture behaviour over which the company has no or very little control. Could, for example, the criminal acts of a subsidiary be said to be furthering the business objectives of the parent company? A parent company will benefit, indirectly, from its subsidiaries entering into more profitable contracts; however, were one of those contracts to have been procured through fraudulent means, should the parent company be exposed to criminal liability? We consider this would be a step too far and would not reflect the reality that subsidiaries are often independent entities over which parent companies have limited control. This is particularly relevant in the context of private equity owned portfolio companies which may be subsidiary undertakings of the fund owner, but which are managed at the portfolio company level. Extending criminal liability up to the fund level would be inappropriate and the potential risk of this exposure would be a serious impediment to investment in UK companies. Any benefits the parent entity has received as a result of the subsidiary's criminal activity (for example, via dividends) may be recovered through existing civil recovery procedures. We suggest that is the more appropriate means of addressing the parent company or undertaking's incidental and indirect involvement.

Equally, it is unclear what the threshold need be for the act to be considered to be in furtherance of a company's business objectives. In cases of fraud or false accounting, the company may itself be the victim of economic crime. Clearly it would be appropriate to prescribe that fraud on the company would be excluded from the scope of a corporate offence.

Scope of offence: extraterritoriality

The general principle is that criminal offences are best dealt with by the criminal justice system of the country in which they occur. There should be compelling policy reasons to move away from this principle and we do not believe that the case for these has been made.

A broader extraterritorial reach creates a greater compliance burden on companies. It is important that any such burden is proportionate to the economic harm that the offence seeks to prevent and we do not believe that such burden would be proportionate in this context. If such an extraterritorial reach were to form part of any corporate offence, it would be crucial that this be accompanied with clear guidance, as early as possible, as to its practical implication for companies. We would query whether this approach may also lead to future investments being structured so as to avoid such extraterritorial reach and would therefore indirectly have a detrimental impact on investment in the UK.

We note that all the predicate offences already have extraterritorial elements. A corporate offence should not extend this.

Scope of prevention procedures for each predicate offence (either as a basis for defence (option 3) or a basis for prosecution (option 4)

The key issue here would be, given the scope and nature of the types of offences likely to comprise economic crime, the difficulty of defining clear, unambiguous expectations on prevention procedures by reference to the individual predicate offences.

For example, how would a company implement an effective policy and structure to prevent fraudulent misrepresentation by employees? What would money laundering policies look like in non-regulated sectors (for example, in retail)? Would this effectively impose regulatory standards on non-regulated sectors? We discuss further below why we do not think that this would be appropriate.

How high would the bar be set to mount a successful defence of adequate prevention procedures? This approach is likely to be particularly burdensome for non-regulated sectors and we would query whether the costs of compliance (particularly if the regime has extraterritorial reach) are proportionate to the desired benefit. Or, would guidance support some form of risk-based assessment as to whether specific policies to prevent certain elements of economic crime are required for companies operating in certain sectors or markets? Certainty is necessary for businesses operating in the UK to be competitive and, therefore, clear guidance must be available for companies and their advisers to properly understand what constitutes adequate procedures. We are of the view that there will be significant practical difficulties providing companies with suitable guidance given the myriad of different kinds and sizes of corporate entities that operate in the UK.

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?

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

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?

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?

Our view is that an extension of the Senior Managers Regime ("SMR") to non-regulated industries would not be appropriate.

Although the extension of the SMR to non-regulated industries may encourage the introduction of systems and controls which seek to prevent certain economic crimes (as it may encourage an individual with responsibility for a particular business area to ensure that there are adequate systems are controls in place), extending the SMR to non-regulated industries fails to acknowledge that a culture of compliance and vigilance is rarely dependent on specific individuals but is more likely to be a product of broader corporate culture.

The application of the SMR to the financial services sector is more appropriate in this context because the sector is regulated, meaning that the same standards are applicable to each financial institution, the benchmark required by the regulator is clearer and the framework that those entities operate in is and has always been more clearly defined. As a result, it ought to be possible for financial institutions to map responsibilities to specific individuals as the functions that those institutions must have are more clearly set out by the regulator.

Here it is important to note, however, that even the FCA has acknowledged that financial institutions have struggled with the introduction of the SMR which has led to spiralling costs of compliance, difficulties in identifying sufficiently senior individuals to hold senior management responsibilities, and issues with adequately mapping out responsibilities, as well as the obvious difficulties of individuals based overseas being responsible or partially responsible for properly designated SMR roles. In addition, there is widespread concern within the financial services sector that the introduction of the SMR will deter quality individuals from entering the sector (as they are unwilling to take on the personal risk inherent in the role), in turn leading to the risk that compliance may be undermined. It should also be noted that the SMR is still to be implemented by the broader financial services industry in 2017 as it currently applies to banks and insurance companies.

Non-regulated sectors have no such framework to operate in. While some standards are expected, there is no single defined benchmark standard that is required of all corporates. It is therefore likely that the extension of the SMR to other industries would generate widespread confusion by both the companies affected and by the courts required to apply these standards.

Broader issues

Impact on investment in the UK

The UK is a global hub for private equity and venture capital and our investor base includes pension funds, insurance companies, sovereign wealth funds and corporate investors. However, today's investors are mobile and generally jurisdictionally agnostic and so, given the current climate, there is a genuine concern that reform could have a negative impact on investment in the UK, particularly if it were not implemented appropriately and proportionately.

Lack of investment and professionalism

Private equity and venture capital firms are long-term investors, typically investing in unquoted companies for around three to seven years. This is a commitment to building lasting and sustainable value in business.

A key role of the private equity and venture capital industry in the UK is the professionalism of private companies through, among other things: (i) the implementation of good corporate governance (including anti-bribery and corruption policies); and (ii) the appointment of experienced directors to the boards of portfolio companies.

At the portfolio company level, broadening the scope of corporate liability for economic crime may well result in responsible investors shying away from investing in difficult businesses in difficult markets or sectors – precisely the companies that are at most risk. Certainly this would be the case if the scope were broadened such that liability for the actions of a portfolio company could potentially attach to the investor. If a portfolio company is found liable for an economic crime, the investor will in any case suffer loss through depreciation in the value of their investment and by way of reputation. This approach would be particularly inequitable, for example, where the ownership of the portfolio company has changed hands since the offence was committed.

Flight of talent

If the scope of corporate liability for economic crime is broadened such that it may increase the personal risk for directors, managers and investment professionals, this could result in an increasing number of talented individuals not wishing to submit themselves to this level of risk and discourage investment in UK business.

One advantage of the UK corporate governance structure is the combination of executive and non-executive directors. It is important for good governance to have independent, investment professionals on company boards. Non-executive directors, in particular, would likely be reticent to submit themselves to an increased level of personal liability or risk if they could be found liable for actions of which they have no knowledge or only fleeting awareness.

Cost

As referenced throughout this response, any increased compliance burden will have a direct cost impact on UK businesses. The resulting impact on investment interest in UK companies should be considered in the context of the perceived mischief which any proposed reform is seeking to address.

General approach to reform

In order to promote investor, business and consumer confidence, economic growth and to reduce costs of compliance, it is crucial that the UK adopts a consistent, coherent and co-ordinated approach to enforcement and any reform in related legislative areas.

The BVCA is happy to expand upon any of the points contained in this submission. In the first instance, please contact Gurpreet Manku (gmanku@bvca.co.uk).

Yours faithfully,

Amy Mahon
Chair, BVCA Legal & Accounting Committee