THE SCOPE OF LIABILITY FOR FAILURE TO PREVENT ECONOMIC CRIME

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There is a strong case for the introduction of a general offence of corporate failure to prevent economic crime. We consider the principles that should govern the scope of such an offence. We argue that existing criteria for the application of failure-to-prevent offences respecting the criminal conduct of employees, agents and subsidiary companies - are unsatisfactory. Our main concern is the parent-subsidiary company relationship. However, we develop a new focus, more generally, for understanding the connection that must be established between a company, and person who committed the crime. This is a focus on the nature and extent of any supervisory duty that existed on the (parent) company to establish and oversee the observance of appropriate standards relating to the course of the conduct that gave rise to the offence. We call this the 'supervisory principle'.

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1. Introduction: When X is Liable, Respecting Y's Wrongdoing

An offence of corporate failure to prevent crime is an example of a more general phenomenon in which criminal liability is imposed on X with respect to Y's wrongdoing. The foundation for this kind of liability may be laid in different ways. One way is through establishing a causal connection between X, and Y's wrongdoing. For example, what matters in cases of complicity through encouragement or assistance, is that X's (in)action played a part in encouraging or assisting Y to engage in the wrongdoing.[1] However, in order to lay a foundation for the imposition of criminal liability on X, the link between X, and Y's wrongdoing need not be in such a manner causal.

Instead, what may matter are key normative features of the relationship between X and Y, and hence between X and Y's wrongdoing. This is how things stand in vicarious liability cases, in which an employer has (*ex hypothesi*) failed to prevent wrongdoing by an employee or agent.[2] X may be vicariously liable for Y's wrongdoing (on the basis of attribution) if fairly stringent normative conditions are met. Broadly speaking, Y's wrongdoing must be committed when Y is

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[1] For theoretical emphasis on the importance of causation in complicity cases, see John Gardner, 'Complicity and Causality' (2007) Criminal Law and Philosophy 127.

[2] See the discussion in David Ormerod and Karl Laird, *Smith and Hogan's Criminal Law*, 14th edition (Oxford: Oxford University Press, 2015), ch 10.2. Vicarious liability for offending is not doctrinally to be equated with a failure to prevent offending. In the former case, the employee's or agent's wrongdoing is attributed to the employer, whereas in the latter case the failure to prevent the wrongdoing is in itself a kind of wrong. See, further, Law Commission, *Criminal Liability in Regulatory Contexts* (CP No. 195, 2010), Part 7. This point does not affect the argument made in the text.

one of X's employees or agents, and Y must be acting within the scope of his or her authority.[3] The satisfaction of these conditions can help to explain what makes it fair, in the law of tort, to make the company bear the cost of loss suffered by the victim of the wrongdoing. However, what matters here is how these normative conditions justify the imposition of criminal liability on the company respecting the wrong done. In that regard, one way of understanding the conditions is as conditions that specify when employees or agents, in acting as they do, in effect represent the company itself: hence, making it fair to regard their wrongdoing as effectively the wrongdoing of the company itself.[4] However, there is another way of understanding them, as conditions which, if satisfied, make it fair to attribute the offender's crime to the company. This involves a focus on a finding that the offender's conduct formed part of an area of activity with respect to which it would be reasonable to expect the company to have established systematic control or oversight over the offender's activities.[5] For present purposes, it is the latter analysis that will be more important. How do the corporate failure-to-prevent offences

[3] *Quality Dairies (York) v Pedley* [1952] 1 KB 275; *Adams v Camfoni* [1929] 1 KB 95. Vicarious liability in private law is further considered below.

[4] See Mark D'Sousa, 'The Corporate Agent in Criminal Law – An Argument for Comprehensive Identification' (2020) 79 Cambridge Law Journal 91.

[5] In a civil law context, see the emphasis placed by the Supreme Court on the element of 'control' exercised by an employer over an employee, in determining whether to impose vicarious liability: *Cox v Ministry of Justice* [2016] UKSC 10, paras 20-23 (Lord Reed).

created in recent years (discussed in more detail below[6]) fit into this picture, if at all?

2. The Supervisory Principle

The corporate failure-to-prevent offences do not impose in-principle liability on a company, respecting wrongdoing by others, by requiring that there was any direct causal connection between the company's inaction and the wrongdoing.[7] However, neither do the offences establish conditions for a normative 'supervisory' connection between the company and the wrongdoer (and hence between the company and the wrongdoing). Such a connection would make it clear that the company could reasonably have been expected systematically to exercise oversight or control over the area of activity of which the wrongdoing formed a part. Instead, the legislature has sought to inculpate the parent company, in principle, by linking its inaction to the offender (and hence to the wrongdoing) through the use of a normatively vague or ambiguous concept: that of the offender's 'association' with the company.[8] The use of this concept linking the offender and the company is meant – rightly - to ensure that

[6] Bribery Act 2010, s.7; Criminal Finances Act 2017, ss 45 & 46.

[7] In orthodox causal terms, the company's inaction is merely the setting in which the offence takes place: *R v Smith* [1959] 2 QB 35.

[8] See e.g. Bribery Act The legislature has then left it to the company to exculpate itself by arguing that the procedures that it had in place to govern its relationship with the offender with whom it was 'associated' were, in all the circumstances, 'adequate' or 'reasonable' procedures.

independent contractors, and even those volunteering services, are included within the scope of those for whose criminal actions the company may have to take responsibility, in a way that would not be permitted if traditional vicarious liability principles were followed.[9] However, as we will see, the concept of 'association' is not, by its nature, necessarily linked to any expectation that the company will supervise the activities of the wrongdoer in any relevant respect. So, the link between the company and the ultimate wrongdoing is normatively weak and lacking a principled basis.

The use of a vague concept, 'association', to link the company and the offender, and hence justify imposing liability on the former for the wrongdoing of the latter, faces a formidable theoretical objection from an orthodox perspective on the limits of criminal responsibility. In principle, no one should be convicted of an offence for a simple failure to prevent another person committing a wrong, if they were not under a duty to (do something to) prevent that wrong being done by the other person in the first place. That is so, even if the wrongdoing would ordinarily have been prevented, had safeguarding procedures been put in place by the person who did not prevent the wrong occurring. If I am your neighbour, then there is an 'association'

[9] See, in a civil law context, *Barclays Bank v Various Claimants* [2020] UKSC 13.

between us. However, if I am not under a duty to stop trespassers entering your land from mine to commit a crime on your land, then if that happens, there is no basis for a case against me (in civil or criminal law). That is so, even if, had I erected a higher fence or employed a guard to keep watch, these steps would ordinarily have been sufficient to stop the trespassing and hence the crime.[10] What this tells us is that the justification for and scope of liability for failure-to-prevent crime ought to turn (in part) on whether or not the connection – the 'association' - between the wrongdoer and the person who failed to prevent the wrongdoing came in a particular form. There must have been an in-principle duty either directly to prevent the wrongdoing, or (at least) to have set and overseen the operation of standards binding on the offender which, had they been followed, would have meant that wrongdoing was avoided.

Existing corporate failure-to-prevent offences lack clarity concerning whether this basic principle is incorporated into the test for inculpation. Having said that, there are two ways in which English law does in fact try to give clearer normative structure to the imposition of in-principle liability on companies, for failing to prevent a relevant economic crime by someone 'associated' with the company. First,

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[10] For a general discussion, see Andrew Ashworth, *Positive Obligations in Criminal Law* (London: Hart Publishing, 2014), ch 2.

under section 7 of the Bribery Act 2010 (‘the 2010 Act’), there is a focus on the nature of the act done by the wrongdoer. Secondly, under sections 45 and 46 of the Criminal Finances Act 2017 (‘the 2017 Act’), there is a focus on the capacity in which the act was done. However, these tests are liable to prove either under or over-inclusive, arguably leaving too many important issues to be settled on a case-by-case basis. We argue in favour of a different test which, following from the analysis given above, can be called the ‘supervisory principle’. This is the test of whether the company was under a duty to establish and supervise the observance of the business standards that ought to have governed the offender, in relation to their course of conduct. By ‘business standards,’ we do not mean only applicable legal and ethical commercial standards for trading (such as duties to avoid bribery, fraud, conflicts of interest, and so on). We also mean, for example, security standards for personal data storage and use, and standards governing access to confidential material more generally.[11] A firm that places temptation in the way of employees by allowing them, say, unrestricted or unsupervised access to accounts and sensitive records, which may then be used for dishonest purposes such as general ledger

[11] For example, a firm might bear responsibility for making it too easy for a departing employee to email themselves a copy of client details: a criminal breach of the Data Protection Act 1988, s.55: https://www.wablegal.com/criminal-liability-data-protection-breach-departing-employee/.

fraud,[12] has not established or overseen appropriate business standards.

It might be possible for the courts to interpret existing failure-to-prevent offences to reflect the supervisory principle. However, there is also recent legislation in the Republic of Ireland that appears to embody that principle clearly in its drafting. This legislation would provide a better model than the existing UK failure-to-prevent offences for any new offence of failure to prevent economic crime.[13] Section 5 of the Criminal Justice (Theft and Fraud Offences) (Amendment) Bill 2020 creates an offence in the following circumstances, designed to punish corporate fraud against EU institutions:

> Where a relevant offence is committed for the benefit of a body corporate by a relevant person and the commission of the relevant offence is attributable to the failure, by a director, manager, secretary or other officer of the body corporate…to exercise, at the time of the commission of the relevant offence and in all the circumstances of the case, the requisite degree of

[12] https://www.bankingexchange.com/risk-management/item/2280-4-internal-frauds-and-how-to-spot-them (last accessed 23/06/2021).

[13] Law Commission, *Corporate Criminal Liability: A Discussion Paper* (2021), https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2021/06/Corporate-Criminal-Liability-Discussion-Paper.pdf, ch 3.

> supervision or control of the relevant person, the body corporate shall be guilty of an offence.[14]

As we will see, this offence is in a way similar to the failure-to-prevent bribery offence under the 2010 Act, in that it depends on a link, between the bribery and the company, being established through the 'relevant person's' (the offender's) intention to 'benefit' the company.[15] However, crucially, liability is also dependent on whether or not, in all the circumstances, a company director (or equivalent person) has failed to exercise the 'requisite' degree of supervision and control over the offender, at the time of the offence. We suggest that the word 'requisite' here indicates that what will matter is the applicability of the supervisory principle. The issue will be whether the company officer in question had a duty to establish and exercise supervisory control over the offender, in respect of his or her conduct, bearing in mind the nature of the offender's relationship with the company. That is a more rational and coherent approach than the approach of the 2010 and 2017 Acts to corporate failure to prevent economic crime.

3. **Failure to Prevent Crime: The Current Approach to Scope**

[14] It will be a defence for the company to show that it, 'took all reasonable steps and exercised all due diligence to avoid the commission of the offence.'

[15] The 2020 Bill indicates that a 'relevant person' can be an employee, agent or subsidiary.

The 'identification principle' governs the liability of companies for fault-based crimes such as fraud or false accounting.[16] For a company to be liable for such a crime, the principle requires proof that the crime was committed by a controlling officer: someone with a 'directing mind and will,' as determined in or through the memorandum and articles of association.[17] Notoriously, the need for the prosecution to satisfy the identification principle means that, however neglectful the company's attitude towards crime-prevention, it will not itself be liable for fault-based crimes committed by its employees, even when they (felt entitled to) act to benefit the company through such means. That is so, even if the Directors were well aware of significant failings in their crime-prevention procedures and did nothing to remedy them. One of the functions of failure-to-prevent offences is to fill this 'liability gap'.

(i) *The scope of liability under section 7 of the BA 2010.*

Under section 7 of the Bribery Act 2010, a company (B) may be criminally liable for a failure to prevent bribery committed by someone (P) 'associated with' B.[18] In virtue of section 8 of the 2010 Act, P is a

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[16] For a helpful recent summary of the identification principle, and its defects, see Law Commission, n. 8 above, ch 2. See also https://www.thetimes.co.uk/article/sfo-boss-lisa-osofsky-says-deferred-prosecutions-vital-to-tackle-white-collar-crime-2crb8sk2n (last accessed 30/06/2021).

[17] *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153. The identification principle was recently affirmed in *SFO v Barclays* [2018] EWHC 3055 (QB).

[18] We use 'B' for the company, rather than 'C', and 'P' for the individual rather than 'A' ('C' and 'A' respectively are used in the legislation itself), in order not to create confusion with the terminology used in the Criminal Finances Act 2017.

person who performs services (disregarding, in that respect, the payment of the bribe in question), 'for or on behalf of B', irrespective of the capacity in which P does this: be it (say) as an employee, agent or subsidiary. In that regard, B commits the failure-to-prevent offence when P bribes another person intending either to obtain or retain business for B, or to obtain or retain an advantage in the conduct of business for B.

Whether or not P is performing services for or on behalf of B is to be determined, 'by reference to all the relevant circumstances, and not merely by reference to the nature of the relationship between P and B'.[19] Accordingly, the fact that B believes P to be performing services for it or on its behalf, or contrariwise, that B emphatically rejects this contention, are just factors to be taken into account in deciding whether, in all the circumstances, the jury is persuaded that P was performing services for or on behalf of B, when the bribe was paid. Even so, the exclusion of the bribe payment itself, as a basis for saying that P is performing services for or on behalf of B, does important work in limiting the scope of B's responsibilities in this respect. A company should not be, and under the 2010 Act is not, responsible for the conduct of just anyone who pays a bribe to benefit

[19] Bribery Act 2010, s.8(4).

the company. It would, for example, be absurd if B could be liable under section 7 when, taking the initiative without any connection to B, a Trade Minister bribed an official in another country to favour B (a company the Minister simply admires) when conducting a public procurement exercise. The 2010 Act avoids that result.

However, as indicated in section 2 above, the 2010 Act still does too little to explain what the normative basis of the relationship between P and B must be, in order to justify imposing liability on B for P's crime. To give an example - implausible though it might seem, on the facts - suppose that P is a part-time window cleaner with a weekly contract to clean the windows at B's premises, but that (without B knowing or having any reason to know this) P also moonlights as a business 'fixer' in his home country, Greyland. Whilst cleaning windows at B's premises, P comes by chance across papers indicating that B will shortly be investing in Greyland. P sees a chance to ingratiate himself with Greyland officials, if B's enterprise is successful. Without telling B, P offers bribes to Greyland officials to smooth the path for B to receive the necessary permits to kick-start their investment programme. In this example, by way of contrast with the Trade Minister example given above, P is 'associated' with B in that P is performing services for B (window cleaning), and offers a

bribe to obtain an advantage in the conduct of business for B. So, in principle, B may be liable under section 7 of the 2010 Act for failing to prevent that bribe being offered.

No doubt, in such a case, B would not be prosecuted, because there is only the most tenuous of connections between the provision of services by P for B and the offer of the bribe by P to benefit B. Nonetheless, section 8(2) of the 2010 Act makes it quite clear that, 'the capacity in which [P] performs services for or on behalf of [B] does not matter'. Accordingly, the example indicates that the focus of section 7 of the 2010 Act ought to be different. The issue should be governed by the supervisory principle, described above. The issue should be whether, when the bribe was offered, B was under a duty to establish and oversee the standards to be observed by P in doing business for or on behalf of B with the Greyland officials. Applying such a test, B would not be responsible for the bribery offence committed in this example, because B's oversight duties clearly did not extend to P's dealings with the Greyland officials. It is submitted that this test is more principled, but not unduly narrow. For example, as a matter of common sense, in any case where a firm has appointed someone to do corporate business on their behalf, even on a voluntary basis, the duty would ordinarily come into operation as a matter of course.

(ii) *The scope of liability under sections 45 and 46 of the CFA 2017.*

In virtue of sections 45 and 46 of the Criminal Finances Act 2017, it is an offence for a company to fail to prevent the facilitation of tax evasion by an 'associated person'. Section 45, focused on UK tax offences, says that a 'relevant body (B) is guilty of an offence if a person (P) commits a UK tax evasion facilitation offence when acting in the capacity of a person associated with B.' A relevant body (B) is a company or partnership (the further details need not concern us here), but more importantly for present purposes, section 44(4) indicates that P acts 'in the capacity of someone associated with B', if P is:

> (a) an employee of B who is acting in the capacity of an employee,
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> (b) an agent of B (other than an employee) who is acting in the capacity of an agent, or
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> (c) any other person who performs services for or on behalf of B who is acting in the capacity of a person performing such services.

Following the 2010 Act in this respect, section 44(5) goes on to add that, in interpreting section 44(4)(c), the question of whether or not P is a person who provides services for or on behalf of B is to be determined by reference to all the relevant circumstances and not

merely by reference to the nature of the relationship between P and B. On the face of it, thus, under the 2017 Act, the meaning of someone 'associated' with a company, for whose criminal actions the company will itself be responsible, appears to be broadly the same as under the 2010 Act. However, all is not as it seems.

For the offences under section 45 and 46 to be committed by B, P must not merely be providing a service for or on behalf of B, when facilitating tax evasion. P must facilitate tax evasion when acting in the 'capacity' of someone providing such a service. Arguably, this would exclude the 'window cleaner' example, given above, from the scope of the failure-to-prevent facilitation offences in which the offender was providing a service for B at the time he committed the (unconnected) predicate offence. That is because the window cleaner clearly did not commit the predicate offence in his 'capacity' as someone offering services (window cleaning) to B. It is an improvement in the drafting of the offences under the 2017 Act that the predicate offence (in this case, facilitating tax evasion) must be committed by P in P's capacity as someone providing services for B, the corporate body. However, the reach of the section 45 and 46 offences is nonetheless potentially over-extensive in a different way.

By way of contrast with the offence created by section 7 of the 2010 Act, there is no restriction on the cases covered by sections 45 and 46 of the 2017 Act to instances in which P (the offender) acts in order to benefit B (the company).[20] It is seemingly enough that P facilitated tax evasion, when acting in the capacity of someone providing services for B, whatever the purpose in pursuit of which P acted. Karl Laird rightly asks whether, for example, the legislature intended that B should be liable for a facilitation offence committed by an employee P, when P's aim was purely to benefit themselves.[21] The answer depends on whether, in all the circumstances, if an employee uses his or her position for self-enrichment through facilitation of tax evasion, that will be regarded as falling outside the scope of conduct engaged in 'in the capacity' of someone providing services for B. In case anyone thinks that the answer is obviously that, in such cases, P was *not* acting in such a capacity, we note the position in English private law governing the scope of vicarious liability. In determining the scope of an employer's vicarious liability, the basic question is whether the wrongful conduct was so 'closely connected' with acts the employee was authorised to do that, for the purposes of

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[20] See the detailed analysis by Karl Laird, 'The Criminal Finances Act: An Introduction' [2017] Crim LR 915, 932-33.

[21] Ibid.

the liability of the employer to third parties, it may fairly and properly be regarded as done by the employee while acting in the ordinary course of their employment.[22] This test gives broad scope for attributing the acts of employees to employers. For example, consider the scope that currently exists to find an employer vicariously liable, in respect of criminal harm suffered by a victim at the hands of an employee. Vicarious liability may be imposed, despite the fact that the wrongdoing in question committed by the employee was intentional, unauthorised, unknown to the employer, and intended solely to benefit the employee.[23]

Interpretive difficulties are not, though, confined to instances of self-enrichment. Suppose an employee or agent (P) of B – a tax advice company - facilitates tax evasion on the part of X, a company that B has expressly prohibited P from contacting in the course of business. P engaged in the facilitation because he or she personally believed that business is business, and inter-firm feuds should not get in the way of making profit (even by facilitating tax evasion). Will P then be regarded as having acted outside the scope of his or her ‘capacity’ as a provider of services to B? In the USA, employers have been found guilty

[22] *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366 (HL); *WM Morrison Supermarkets PLV v Various Claimants* [2020] UKSC 12.
[23] See *Lister v Hesley Hall Ltd* [2002] 1 AC 215.

of offences based on the criminal acts of employees, even when those employees were acting contrary to instructions.[24]

In interpreting the limits of sections 45 and 46 of the 2017 Act, it would probably not be desirable for the courts to have extensive recourse to the private law doctrine of vicarious liability, or to US criminal jurisprudence on that issue, when seeking to explain to the jury the limits of acting in the 'capacity' of someone providing services for B.[25] As we indicated in relation to section 7 of the 2010 Act, a better approach would involve asking a different question, involving an application of the supervisory principle. The question should be, 'was B under a duty to supervise or oversee the standards to be observed by P, in relation to the course of conduct on which P embarked'? In answering that question, it will not necessarily be a decisive answer, one way or another, that P was acting for his or her own benefit. Perhaps B, in the particular employment context, should have given P training and education on how to avoid falling prey to the particular kind of temptation in issue. Similarly, the mere fact that P is acting contrary to express instructions from B should not necessarily make all the difference (leading B to be exonerated). That might depend on

[24] *United States v Hilton Hotels Corp* 467 F.2d 1000, 1004-07 (9th Circuit 1972); *United States v American Radiator & Standard Sanitary Corp* 433 F.2d 174, 204-05 (3d Circuit 1970).

[25] For a discussion, in a US context, see Andrew Weissmann, 'A New Approach to Corporate Criminal Liability' (2007) 44 American Criminal Law Review 1319.

how much clarity B provided – or should have provided - to P, on how to strike an ethical balance between the exercise of initiative or use of creativity in pursuit of profit, and the need to follow employer policy.

(iii) *Liability of parent companies for the acts of subsidiaries*.

In the analysis that follows, we will assume that, in some form, the connection between the firm (B) and the person who commits an economic crime (P) – whether it is bribery, fraud, facilitation of tax evasion, *etc* – ought to be established through an examination of the nature and extent of the duties B had to establish and oversee the standards of conduct to be observed by P relating to the wrongdoing in question. Our focus will be the way in which such a test, an application of the supervisory principle, impacts on the responsibility of parent companies for the criminal acts of their subsidiaries.

The general law acknowledges a relatively clear separation of responsibilities, as between parent companies and their subsidiaries:

> Our law for better or worse, recognises the creation of subsidiary companies which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and

liabilities which would normally attach to separate legal entities.[26]

Nonetheless, the current law governing failure-to-prevent offences is clear that a parent company may be liable for the criminal acts of a subsidiary, if the tests set down to determine such liability (examined above) are met. For example, if a subsidiary is a sham company,[27] or an agent of the parent (a matter to be determined on the facts, in civil law[28]), then the subsidiary will be acting in the capacity of a person providing services for or on behalf of the parent company. Such an approach broadly reflects the policy of the US Department of Justice in relation to prosecution of corporations for the criminal acts of their subsidiaries under the Foreign Corrupt Practices Act 1977. A parent company may be prosecuted, in such circumstances, not only when it authorised the subsidiary's specific criminal acts, but also when its knowledge and direction of the subsidiary's actions more generally showed that it effectively controlled the actions of the subsidiary.[29]

Is it true, though, that almost by definition a subsidiary company acts in a capacity of providing services for or on behalf the parent company? The permissive language of existing failure-to-prevent

[26] *Adams v Cape Industries Plc* [1990] 1 Ch 433 at 536 per Slade LJ.
[27] *See Wolfson v Strathclyde Regional Council* [1978] SLT 159.
[28] *Smith, Stone and Knight v City of Birmingham* (1939) 4 All ER 116.
[29] US Department of Justice, *FCPA: A Resource Guide to the US Foreign Corrupt Practices Act*, 2nd ed (2020), https://www.justice.gov/criminal-fraud/file/1292051/download, 28.

offences suggests that this is not the case; and indeed, a subsidiary may or may not act in such a capacity, depending on the facts. A subsidiary may enjoy a good deal of autonomy in its dealings, perhaps being just one of a large number of such bodies – operating in very different commercial fields - owned by a parent company. As a real entity in itself, a subsidiary may over a number of years legitimately develop its own way of doing business, its own processes, procedures and culture. In such circumstances, when should a parent company be held responsible for an economic crime committed by a subsidiary (or by one of its employees)? In the next section, we try to answer that question by considering when a parent can or should be regarded as having taken responsibility for the oversight or supervision of the standards to be observed by the subsidiary in the conduct of its business.

4. **Parent Responsibility for a Subsidiary's Standards of Conduct**. There is no doubt that, in a private law context, parent companies can be responsible for the standards of conduct observed by their subsidiaries. In *Chandler v Cape*,[30] Chandler had contracted asbestosis as a result of working for a Cape Ltd subsidiary, Cape Building Products Ltd, some fifty years before. The subsidiary was no longer trading, and

[30] [2012] EWCA Civ 525. See also *Lungowe v Vandata and KCM* (2017) EWCA Civ 1528.

so Chandler brought an action in tort against Cape Ltd. The Court of Appeal upheld his claim that Cape Ltd had itself assumed a responsibility for protecting his health from the risks of asbestos, and breached their duty of care to him through negligence.

The court did not set down an exclusive list of circumstances in which a parent company would be found to have assumed a responsibility towards third parties dealing with one of its subsidiaries.[31] However, factors mentioned included that the parent company was responsible for, (a) 'high level advice or strategy' that the subsidiary was expected to follow,[32] (b) that the businesses of the parent and subsidiary were in a relevant respect the same, (c) that the subsidiary's system of work was unsafe as the parent company knew or ought to have known, and (d) that the parent knew or ought to have foreseen that the subsidiary or its employees would rely on the parent's superior knowledge for the employees' protection.[33] The court added that:

> The court will look at the relationship between the companies more widely. The court may find that…[a duty] is established

[31] [2012] EWCA Civ 525, para 80.
[32] [2012] EWCA Civ 525, para 66.
[33] [2012] EWCA Civ 525, para 80. See, further, *AAA v Unilever PC & Unilever Tea Kenya Ltd* [2018] EWCA Civ 1532.

where the evidence shows that the parent has a practice of intervening in the trading operations of the subsidiary.[34]

It is always possible to argue that cases determining the scope of private law duties have no relevance or application to the criminal law. However, that argument is a double-edged sword, so far as determining the scope of a duty is concerned. In some instances, the duty of care may be wider in criminal law than it is in private law.[35]

In *Cape*, the basis of the duty owed by the parent was its supposedly superior knowledge of health and safety matters. Even so, as the court indicated,[36] such a duty might arise from other, 'high level advice or strategy' considerations in respect of which a parent company sets the tone for its subsidiaries. One such high level advice or strategy matter is legal and ethical business practice. Accordingly, the relevance of the *Cape* decision is that it can be relied on to argue, by analogy, that a parent company may in some circumstances owe a duty of care to third parties to ensure that the subsidiary minimises or eliminates the risk that it may engage in economic crime. In a simple case, such a duty might arise through the parent company's conduct in, for example, insisting on a formal agreement with the subsidiary

[34] [2012] EWCA Civ 525, para 80.

[35] An example is provided by *Willoughby* [2004] EWCA Crim 3365, in which the Court of Appeal refused to apply the private law doctrine of *ex turpi causa* to limit the scope of a duty of care.

[36] See text at n. 30 above.

that the latter will implement the parent company's 'zero tolerance' policy towards economic crime. In accordance with the *Cape* principles just set out, it could then be argued that the parent company's concern about reputational risks led it to have an ongoing responsibility for the way that the subsidiary manages the risk that it might become involved in economic crime.

In the example just given, as in *Cape*, the source of the duty to oversee or supervise the observance of standards in business practices is the particular conduct of the parent towards its subsidiary. However, it ought also to be possible for the legislature, or the courts, to rule that – other than in exceptional circumstances - such a duty will automatically apply in some cases. An example might be the preparation of accounts. A subsidiary prepares its own accounts; but in order – as required by law[37] – to present a 'true and fair view' of its own accounts, a parent company must ordinarily incorporate a subsidiary's accounts into its own.[38] In that regard, it is an offence under section 501(4) of the Companies Act 2006 to fail to obtain, from an overseas subsidiary undertaking, information for the purposes of audit. It ought to follow that a main company has a duty to ensure that the accounts of a subsidiary meet the national and international

[37] Companies Act 2006, s.393.
[38] Companies Act 2006, s.399.

standards the parent company is required to observe for its own accounts, even if (say) the jurisdiction in which the subsidiary operates sets less exacting accounting standards.

In that regard, a good test case for the application of an offence of failure to prevent false accounting is the civil enforcement action taken in *SEC v Oracle*[39] under the Foreign Corrupt Practices Act 1977. In this case, the Securities and Exchange Commission (SEC) alleged that employees of an Indian subsidiary structured transactions with India's Government on a number of occasions in such a way as to enable Oracle India's distributors to hold some $2.2m in unauthorized side funds. Those employees then directed payments to be made out of these side funds to supposed local vendor organisations, some of which were merely façade outfits that did not provide any services to Oracle. Oracle's subsidiary documented some of the payments with fake invoices. According to the SEC:

> Because the Oracle India employees concealed the existence of the side fund, Oracle did not properly account for these side funds. These funds constituted prepaid marketing expenses

[39] *Securities and Exchange Commission v Oracle Corporation*, Civil Action No. CV-12-4310 CRB (ND Cal August 16, 2012).

> incurred by Oracle India and should have been recorded as an asset and rolled up to Oracle's corporate books and records.[40]

The SEC relied on Oracle's very ignorance of what had been going on at one of its subsidiaries as evidence that Oracle lacked the proper controls to prevent its employees at Oracle India from creating and misusing the parked funds. Oracle agreed to pay a $2 million penalty to settle the SEC's charges.

This might be a case in which the subsidiary employees were acting purely self-interestedly. Alternatively, it might be one in which they were acting in the subsidiary's interests, but contrary to (parent) company policy. Either way, in the context of the current discussion, the question is whether the main company was under a duty to oversee the standards to be observed relating to the conduct undertaken by the employees. One answer to that question might be that whilst the setting up of the side fund – and payments to facade outfits – were issues more within the subsidiary's than the main company's jurisdiction over standards, it is another matter where the failure to record transactions in the subsidiary's accounts is concerned. The obligation to incorporate these accounts into those of the main

[40] Complaint, *SEC v Oracle Corporation*, No. 3:12-cv-04310 (N.D. Cal. 2012), 10-11. See, further, Karen E Woody, 'No Smoke and No Fire: The Rise of Internal Controls Absent Anti-Bribery Violations in FCP Enforcement' [2017] 38 Cardozo Law Review 101, 114.

company arguably carried with it an implied duty to ensure that the accounts met proper standards. In so far as the main company failed in an oversight duty in relation to compilation of those accounts, then the failure ought to fall within the scope of a corporate failure-to-prevent a false accounting offence.[41]

5. **Failure to Prevent Fraud**.

So far, we have discussed the appropriate principle to govern the responsibility in criminal law of a company for economic crimes committed by an 'associated person.' Briefly, we have also discussed the application of that principle, the supervisory principle, to cases of failure to prevent bribery, failure to prevent the facilitation of tax evasion, and (should such an offence be created) failure to prevent false accounting. What about the application of the principle to instances of failure to prevent fraud?

We start by observing that the creation of a failure-to-prevent fraud offence may prove to be controversial in application, giving a Government nervous about adding to compliance 'burdens' on business reason to pause.[42] It would be controversial, in part, because of the

[41] It would still be open to the company to argue in its defence that it had procedures in place that were generally adequate or reasonable for preventing false accounting of the relevant kind.

[42] The Government has already indicated its scepticism concerning the case for introducing new forms of corporate criminal liability, and turned the issue over to the Law Commission. See, for example, Ministry of Justice, *Corporate Liability for Economic Crime: Call for Evidence; Government Response* (Ministry of Justice, 2020), 16.

sheer scale of prosecutorial and corporate concern with fraud. The National Crime Agency claims that fraud is the most commonly experienced crime in the UK,[43] with businesses losing some £140 billion to fraud in 2019.[44] 740,845 alleged fraud offences were reported to the National Fraud Intelligence Bureau,[45] and there were 10,817 prosecutions for fraud (including forgery) in the year ending September 2019.[46] Smaller businesses – the overwhelming majority in the UK - may be as much at risk of encountering fraud as larger ones, at least for certain types of fraud such as invoice fraud.[47] Accordingly, the overall burdens and costs to the private sector of dealing with fraud-prevention are likely to be spread more widely across the business sector, and to be considerably higher than they are for (say) bribery-prevention.

Having said that, evidence suggests that one in every five employees feels pressure to compromise their organization's ethical

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[43] https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/fraud-and-economic-crime (last accessed 21/06/2021).

[44] https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/fraud-and-economic-crime; (last accessed 21/06/2021); see also, https://www.risk-uk.com/annual-fraud-indicator-2017-highlights-uk-footing-190-billion-annual-fraud-bill/ (last accessed 21/06/2021); KPMG, 'Alleged Fraud for 2019 has reached over 1 billion' (2020), https://home.kpmg/uk/en/home/insights/2019/12/alleged-fraud-for-2019-has-reached-over-1-billion-pound.html (last accessed 21/06/2021).

[45] https://www.ons.gov.uk/aboutus/transparencyandgovernance/freedomofinformationfoi/fraud#:~:text=The%20Crime%20Survey%20for%20England,the%20year%20ending%20June%202019.&text=and%20UK%20Finance.-,In%20the%20year%20ending%20June%202019,offences%20of%20fraud%20were%20reported (last accessed 21/06/2021).

[46] https://www.cps.gov.uk/publication/cps-data-summary-quarter-2-2019-2020 (last accessed .23/06/2021).

[47] https://www.ukfinance.org.uk/press/press-releases/businesses-lose-%C2%A393m-invoice-scams-2018-four-ten-unaware-risk (last accessed 23/06/2021)..

standards, policies, or the law.[48] In theory, the introduction of an offence of failure to prevent fraud would give senior managers good reasons to counter-act that incentive through establishing a 'zero-tolerance' set of policies with respect to fraud. However, there is evidence that middle and senior managers at firms are themselves responsible for the perpetration of well over half of corporate fraud.[49] Some of these individuals will be the very people who are meant to be preventing, as opposed to perpetrating, fraud offences. The involvement of management in fraud reflects in part the greater opportunities management has directly or indirectly to raise or channel funds, manufacture or present fraudulent financial information, override controls that otherwise might have operated effectively, and to co-opt employees into becoming accomplices.[50] The mere creation of an offence of failure to prevent fraud may not do much to change these dynamics.

Be that as it may, in terms of the analysis being developed here, the duty to oversee standards relating to the potentially fraudulent

[48] Global Business Ethics Survey (2020), https://www.ethics.org/global-business-ethics-survey/ (last accessed 21/06/2021).
[49] PWC Global and Economic Crime Survey, *Fighting Fraud: A Never-Ending Battle* (2020), www.pwc.com/fraudsurvey. 5; AICPA, *Consideration of Fraud in a Financial Statement Audit*, https://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00316.pdf (2007), 1722, 1723.
[50] Middle and senior managers are also more likely to rationalise at least some fraudulent conduct as being in the firm's interests. See AICPA, n. 46 above, 1723. Arijit Chatterjee and Donald C Hambrick, 'It's All about Me: Narcissistic Chief Executive Officers and Their Effects on Company Strategy and Performance' (2007) 52 ASQ 351.

conduct of employees is ordinarily that of management within the subsidiary firm, and not that of the parent company. In relation to its own staff, the subsidiary (just like the parent) will bear the burden of ensuring that it has robust and transparent external and internal audit procedures,[51] along with adequate security and confidentiality measures in relation to sensitive documents. A failure, in one of these respects, would expose the subsidiary to prosecution for a failure-to-prevent fraud offence. The subsidiary, though, may not be within the jurisdiction. Hence, it may not be subject in its own dealings to the exacting standards expected of the parent. So, putting aside obvious cases (such as when the subsidiary is a mere cat's paw) what are the responsibilities - if any - of a parent company in relation to frauds committed by or on behalf of a subsidiary? As indicated in section 3, a central issue ought to be whether the facts disclose either a *Chandler v Cape* assumption of responsibility for oversight of how the subsidiary manages observance of business standards, or circumstances indicating that the parent ought to have assumed such a responsibility. In that respect, did the parent company, or ought it to have, *inter alia*:

(i) given relevant advice to the subsidiary about how it should manage a particular risk?

[51] On the effectiveness of which, see PWC Global and Economic Crime Survey, n. 49 above, 15. A regulated firm will also have to ensure that it has adequate whistleblowing procedures.

(ii) had a practice of intervening in the trading operations of the subsidiary?

(iii) provided high level strategy guidance to the subsidiary?[52]

It will not be in every case that these criteria are satisfied. Imagine a case in which the parent company is no more than a vehicle for the ownership of a large array of subsidiaries providing a host of different services. In such circumstances, it might be hard to see how the parent company could ordinarily come under an obligation to establish and oversee business standards in the management of its subsidiaries. However, there can sometimes be sound public policy reasons for imposing duties to establish and oversee business standards observed by subsidiaries, even in situations such as this. An example might be where the parent company, through a subsidiary, is engaged in public sector contracting, as in the case of the 2019 Deferred Prosecution Agreement reached between the Serious Fraud Office and Serco Geografix Ltd.[53] In this case, it was the parent company, Serco Ltd, that had the superior knowledge and expertise, the role of the subsidiary (allegedly guilty of fraud and false accounting offences) Serco Geografix - being to bring that knowledge and expertise to bear

[52] See text at n. 32 above.

[53] *SFO v Sercogeografix Ltd* (2019), https://www.judiciary.uk/wp-content/uploads/2019/07/serco-dpa-4.07.19.pdf (Mr Justice William Davies).

on the provision of correctional services for the Ministry of Justice. Beyond the issue of standards of technical expertise, though, in public sector contracting, both parties will be aware of the obligation on the public body to obtain 'best value' in its contracting.[54] The honouring of such an obligation is obviously threatened by fraud (and false accounting) of the kind that was alleged to have been engaged in by Serco Geografix. In that regard, what Lord Bingham has said about the liability of public servants applies equally to private providers of public services (Government spends £284 billion a year on buying goods and services from external suppliers[55]):

> There is an obvious public interest in bringing public servants guilty of outrageous conduct to book. Those who act in such a way should not be free to do so with impunity.[56]

For that reason, in relation to the supply of public services, public policy dictates that there ought always to be a duty on a parent company to establish and oversee the observation by the subsidiary's management of applicable legal and ethical business standards. Where fraud on a public body stems from subsidiary management malpractice (as in the Serco Case), then, as a matter of public policy, it also ought

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[54] Department for Communities and Local Government, *Best Value: Statutory Guidance* (DECLOG, 2011).
[55] Institute for Government, *Government Procurement: The Scale and Nature of Contracting in the UK* (2018), https://www.instituteforgovernment.org.uk/publications/government-procurement (last accessed 21/06/2021).
[56] *Watkins v Home Office* [2006] 2 AC 395, at 403.

to be regarded as reflecting a failure of parent company oversight and supervision. Accordingly, the only question that will remain, for the purposes of a failure-to-prevent fraud offence, will be whether the parent had in place adequate procedures to oversee and supervise the subsidiary's management practices.

6. **Conclusion**.

Strict liability failure-to-prevent offences are the law's answer to the problems for the prosecution involved in satisfying the identification doctrine, when seeking to establish the criminal liability of companies. However, the most important justification for such offences is not that they make the job of the prosecution easier. It is that these offences enable a more sophisticated focus on the relationship between a company, and those whose activities it supervises and oversees rather than simply controls and directs. It is that focus, one which is now central to the regulatory enforcement actions of the SEC (in the USA) and the Financial Conduct Authority in England and Wales, that is most needed by corporate criminal law. As is the case with the new failure-to-prevent fraud offence enacted in Ireland,[57] failure-to-prevent offences should be founded on an allegation that a company failed in a duty to establish and oversee the observance of the appropriate

[57] See text at n. 13 above.

business standards applicable to the criminal conduct engaged in by the offender (employee; agent; subsidiary). Upon proof of such a breach of duty, a breach of what we have called the supervisory principle, it will then be for the company to show that its procedures were reasonable or adequate in all the circumstances.[58]

[58] A key feature of any adequate or reasonable procedures defence in criminal law ought to be a concern with whether or not a company appointed a fit or proper person to ensure that (i) there are adequate systems and processes for deterring and preventing economic crime company-wide and that (ii) all employees, agents and subsidiaries are aware of, accept and follow these systems and processes: see *e.g*. in a regulatory context, the Senior Managers and Certification Regime (2019), https://www.fca.org.uk/firms/senior-managers-certification-regime (Last accessed 21/06/2021). It would not follow, of course, that merely showing that such a person had been appointed would suffice to demonstrate that procedures for economic crime-prevention were in practice adequate; far from it.