Second Deferred Prosecution Agreement approved by the English Court demonstrates the value of Self Reporting

Published 19 July 2016

On 8 July 2016, Judgment was handed down in the case of the Serious Fraud Office v XYZ Limited (Case No. U20150856) in which the second Deferred Prosecution Agreement ("DPA") agreed by the Serious Fraud Office ("SFO") was approved by the Court. This Judgment provides valuable guidance for corporates on the Court's approach to the approval of DPAs and, in particular, the benefits of self-reporting criminal wrongdoing.

The DPA Regime

s.45 and Schedule 17 of the Crime and Courts Act 2013 ("the Act") introduced DPA's into the law of England and Wales for the first time. These provisions allow an agreement to be reached between the prosecutor and the corporate entity facing prosecution for certain defined economic or financial crimes which defers criminal proceedings upon terms. Those terms include the payment of a financial penalty, disgorgement of profits, implementation of a compliance and monitoring programme, co-operation in criminal investigation and payment of costs. However, all DPAs must be approved by the Court.

In the first case in which a DPA was sought, and approved1, the Court gave clear and unequivocal guidance that an application for the approval of a DPA was never to be regarded as a rubber stamping exercise and that the Court would scrutinise all applications made. Further, the SFO also made it clear that DPA's would remain the exception not the rule.

Background

XYZ2 is a UK registered and domiciled SME. It is a wholly owned subsidiary of a US registered corporation (referred to in the Judgment as ABC). Between June 2004 and June 2012, XYZ was involved in the systematic offer and/or payment of bribes to secure contracts in foreign jurisdictions. In total, 28 out of 74 contracts scrutinised were implicated. The offence involved intermediary agents to offer or place bribes with those thought to exert influence or control over the award of contracts. A total of £17.24m was paid to XYZ on the 28 implicated contracts which represented circa 15% of the total turnover of XYZ in the relevant period. The total gross profit derived was some £6.5m, with an estimated net profit of approximately £2.5m arising from the wrongdoing.

How the Wrongdoing was Discovered

In August 2012, ABC implemented its global compliance programme in respect to XYZ. Concerns then came to light about how a number of contracts had been secured. XYZ appointed a law firm to undertake an independent internal investigation in September 2012. The law firm met with the SFO in November 2012 to confirm that a written self-report would be made on the conclusion of the investigation. The written self-report was delivered on 31 January 2013. Subsequently, the SFO opened a criminal investigation and conducted interviews whilst XYZ, through its lawyers, continued to investigate the matter and provided the SFO with further reports and documentation. By the end of 2014, the entirety of the wrongdoing had been identified. Bribery charges were drafted3 and in November 2015, the SFO invited XYZ to commence negotiations for the terms of a DPA.

The Court's Approach to the Approval of DPAs

It must be in the interests of justice to enter into a DPA as opposed to there being a criminal prosecution. An application for approval of a DPA must explain the way in which the interests of justice are served. The following factors fall to be considered:

- The seriousness of the predicate offence or offences;
- The importance of incentivising the exposure and self-reporting of corporate wrongdoing;
- The history (or otherwise) of similar conduct;
- The attention paid to corporate compliance prior to, at the time of and subsequent to the offending;
- The extent to which the entity has changed both its culture and in relation to relevant personnel, and;
- The impact of prosecution on employees and others innocent of any misconduct.

Although all of the above factors were considered by the Court, it was factors 1, 2, 5 and 6 which were ultimately determinative.

As regard factor 1, the more serious the offence, the more likely it is that a prosecution will be required in the public interest and the less likely it is that a DPA will be in the interests of justice. XYZ's conduct was recognised to have been grave, having amounted to a systematic course of conduct spanning some 8 years. It was noted to have been very different from the Standard Bank case which concerned one single incident of bribery by a sister company in the same corporate family.

In dealing with factor 2, the Court recognised that very considerable weight must be attached to incentivising the exposure of corporate wrongdoing given XYZ's conduct since it had discovered the wrongdoing. XYZ had promptly engaged lawyers to undertake an independent investigation and it had engaged with the SFO at an early stage, making a self-report within 5 months of the wrongdoing coming to light. XYZ and its lawyers thereafter co-operated fully with the SFO. The Court recognised that, *"Taken together, XYZ's timely self-reporting and full and genuine co-operation militated very much in favour of finding that a DPA is likely to be in the interests of justice."*

The Court recognised that, as regard Factor 5, XYZ was, in its current form, a different entity to that which committed the wrongdoing. The people involved had been dismissed, relationships with agents involved had been terminated and bids for two potentially tainted contracts had been withdrawn. The SFO's investigation concluded that none of XYZ's current employees and directors faced criminal charges. Consequently, the Court found that XYZ, *"is a culturally different company to that which committed the offence…"*.

Finally, as regard factor 6, XYZ was said to be operating on an *"economic knife-edge"* even without the potentially detrimental effect of a prosecution. Conviction would see XYZ debarred from participating in public contract tenders within the EU. The Court, therefore, accepted that if the DPA was not approved, XYZ would in all likelihood be wound up which would harm the interests of workers, suppliers and the wider community.

The Court concluded that a DPA was in the interests of justice in this case. Although recognising XYZ's conduct was clearly very serious, the Court held that, *"it is important to send a clear message, reflecting a policy choice in bringing DPA's into the law of England and Wales, that a company's shareholders, customers and employees (as well as those with whom it deals) are far better served by self-reporting and putting in place effective compliance structures. When it does so, that openness must be rewarded and be seen to be worthwhile."*

The DPA Terms

Agreement that a DPA is in the interests of justice is one thing. The approval of its terms is another.

The essential feature of a DPA is that it is a deferral of prosecution which can be resumed at any point in the event the corporate entity fails to comply with its terms. At the end of the period of deferral (at least 3 years and up to 5 years) if and only if the corporate has complied with the terms of the DPA will the proceedings be discontinued. Further, the DPA will only operate as regard the corporate entity. There is no protection from prosecution of any present or former officers, employees or agents.

Further to this is the question of the adequacy of the financial settlement. In this case, XYZ agreed to the disgorgement of gross profits (£6.2m) and payment of a financial penalty (£352,000). No compensation was payable as it had not been possible to positively identify any entities as victims who may be compensated.

When considering a financial penalty, any agreement reached between the prosecutor and the corporate entity must be broadly comparable to the fine that a court would have imposed on conviction for the alleged office following a guilty plea. This was a potential stumbling block on the approval of the DPA as it brings into play the Sentencing Council Guidelines4. The essential feature of the Guidelines is that in considering the size of the fine, the seriousness of the conduct is decisive and to work out where on the scale of seriousness the conduct sits, you have to take into account the offender's culpability and any harm caused.

In the present case, XYZ was deemed highly culpable because the offering of bribes had been an accepted way of doing business with the involvement of senior executives who represented its controlling mind. Further, the conduct had occurred over a long period of time. For bribery offences, harm is normally assessed by reference to the gross profits resulting from the conduct. In this case, the gross profits were £6.5m. The Guidelines identify the starting point for a fine where there is a high level of culpability as being 300% of the harm, with a range of 250% to 400% depending on all the circumstances. Even taking the lower end of the scale, the starting point in this case was a financial penalty of £16.4m. The Guidelines do, however, make provision for the Court to "step back" and consider the circumstances in the round. Further, the assumption of a guilty plea brings into play a potentially significant reducing factor. In the present case, it was deemed to have amounted to a 50% reduction in the fine.

Taking the above factors into account, the Court accepted the proposed combined financial settlement of £6.5m as being the appropriate level given all the circumstances. It represented the full disgorgement of gross profits and thus, the Court considered it didn't really matter how you sliced it up. It was accepted that this was as much as XYZ could afford to pay and that to order payment of a greater sum would lead to XYZ being insolvent and at risk of winding up.

Conclusion

XYZ's conduct was clearly very serious and if it had not acted promptly to investigate the wrongdoing, engage with the SFO, self-report and thereafter fully and genuinely co-operate with the SFO's ongoing investigation it may have found it very difficult to avoid a criminal prosecution

Self-reporting criminal wrongdoing will always be a difficult decision to come to terms with. It brings with it an acceptance that criminal conduct has taken place and that, having self-reported, the best that the corporate entity can hope for is a civil penalty. The consequences, however, of not reporting it and it later being discovered are dire. There would be little chance of the corporate avoiding a criminal prosecution.

The Court has made it clear that the statutory introduction of DPAs represents a step change in policy. Corporations are being strongly encouraged to self-report wrongdoing in return for which there will be potentially significant benefits to be had.

Upon identification of potential criminal wrongdoing, a corporate will be well advised to involve its lawyers in undertaking an investigation at an early stage, taking into account the need for preservation and review of potentially substantial amounts of documentation and, if so advised, the need to engage with the criminal authorities.

One issue to consider is whether the costs of undertaking such an investigation at an early stage are covered under any applicable Directors and Officers Insurance. Some Insurers offer cover for costs of investigating matters before a claim has been made, including costs leading to a self-report. Any such investigation will inevitably involve consideration of the actions of Directors and Officers of the company. In this case, former employees are the subject of on going criminal proceedings which themselves may be the subject of an indemnity for defence costs from Insurers, albeit pending any final adjudication of dishonesty, at which point such costs would be repayable to insurers.

[1] SFO v Standard Bank, 4 November 2015

[2] The names of the parties and even their lawyers have been kept confidential pending the outcome of criminal proceedings against the individuals involved in the wrongdoing.

[3] It is worth noting that 24 contracts pre-dated the coming into force of the Bribery Act 2010, with only 4 contracts post dating the Bribery Act. Charges were therefore drafted under the prior bribery laws as well as under the bribery Act, including the s.7 corporate offence of failing to prevent bribery.

[4] https://www.sentencingcouncil.org.uk/wp-content/uploads/Fraud-bribery-and-money-laundering-offences-Definitive-guideline2.pdf

Authors

Jonathan Brogden
London - Walbrook
+44 (0)20 7894 6290
jbrogden@dacbeachcroft.com

Graham Ludlam
London - Walbrook
+44 (0)20 7894 6442
gludlam@dacbeachcroft.com

DAC BEACHCROFT