Perilous times

Is the UK/EU approach to corporation regulation too heavy-handed? **Khawar Qureshi QC** reports

IN BRIEF

- Over the past five years, there have been many examples of the law (civil and criminal) increasingly being used to scrutinise corporate conduct.
- Changes in UK domestic law over the same period have been driven in part by EU harmonisation, which is likely to impact on UK businesses significantly.
- The main impetus for placing corporate behaviour under the microscope has come from the USA post Enron and 9/11.

To understand the present approach to corporate regulation in the UK, it is necessary to appreciate the philosophical dilemma presented by the fact that a company is a creature of law, and to hold it liable under criminal law invariably involves blaming an individual or individuals whose conduct is (artificially) imputed to the company.

Hence, recent trends towards placing greater responsibility upon companies by means of legal regulation are designed to "persuade" them to develop practices and due diligence-based systems, which are aimed at making wrong-doing less likely. It is for that reason that companies may, for example, face big penalties *vis-à-vis* cartel behaviour or corporate manslaughter charges when it is apparent that systems were not in place, were deliberately overridden, or failed to prevent wrongdoing.

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Different societies use their own methods to try to ensure that companies operate within the ambit of the rule of law. However, the use of statute to "put down markers", combined with the activities of regulatory agencies and self regulation, is the essential combination in most societies.

In the wake of various financial scandals—such as Guinness, BCCI, Enron and Worldcom—and post 9/11, there has been a concerted move in many jurisdictions to impose greater financial transparency and corporate accountability.

However, in the UK, we can see the beginnings of this process as early as 1992 with the publication of the Cadbury code, the first *Code of Best Practice on Corporate Governance*, setting out criteria of best practice for UK companies. We therefore need to view recent events in the context of a process of change that had been initiated some time ago, albeit that recent events have provided a sharper focus in this area.

THE UK LEGISLATIVE SCENE

In the UK, some of the most significant statutory changes in this area can be found in the following pieces of legislation:

The Enterprise Act 2002

This changed the role of the Competition Commission and created the Competition Appeal Tribunal to deal with competition issues—while maintaining the primacy of EC Law (Enterprise Act 2002 (EnA 2002), s 12). Section 188 introduces an offence—punishable by up to five years' imprisonment—of "dishonestly" entering into a price-fixing arrangement.

An issue which arose in *Norris v Government of the United States of America* [2007] EWHC 71 (Admin), [2007] 2 All ER 29—alleged price-fixing by Morgan Crucible and its former CEO Ian Norris being extradited to the US—was whether there was any offence at English common law of price-fixing before EnA 2002, s 188 came into effect. This issue will be decided later this year by the House of Lords.

The Extradition Act 2003

This gives effect to the European arrest warrant regime (EAW), and allows the secretary of state to designate states (such as the US) as parties which can make extradition requests without showing evidence to support a *prima facie* case.

The EAW applies in all EU states which have been designated as complying with the EU Framework Decision 2002/630/JHA on police and judicial co-operation in criminal matters of July 2002, and provides for swifter return of individuals than under the previous statutory framework. It is based upon an assumption of "equivalence" between the laws and procedures of the states operating this system. There are human rights safeguards in place, and a right of appeal to the High Court before an individual is returned. However, there is pragmatism in operation—in pursuit of harmonisation—because legal and judicial standards between EU member states are bound to vary.

Rightly or wrongly, the US/UK Extradition Treaty of 2003 has been the subject of much criticism. In the NatWest Three and Ian Norris cases, it was argued that the treaty was lopsided and was only intended to apply to terrorist-type offences. The Divisional Court found in both of these cases that there was nothing inherently unfair in the treaty or the way it was being applied.

However, it is clear that the reality on the ground for extradition has changed sharply. The process is much faster than before—18 months at most from the making of a request to return of the individual, compared with up to six years previously due to availability of multiple legal challenges.

The changes have arisen because there appears to be a consensus between states to the effect that delay undermines justice and, so long as fair trial and human rights safeguards are in place, the extradition process should—it is argued—be much more administrative and less forensic in nature.

The Corporate Manslaughter and Corporate Homicide Act 2007

Instead of requiring a grossly negligent "act or omission" on the part of the "controlling mind" of a company (as previously), the Corporate Manslaughter and Corporate Homicide Act 2007—enacted on 24 July 2007—seeks to create liability for a company, government departments or police forces if (and only if) (cl 1(3)) "the way in which its activities are managed or organised by its senior management is a substantial element" in the "gross breach of a relevant duty of care"—punishable by a fine.

The Fraud Act 2006

This came into effect on 15 January 2007 and is intended to replace much of the

Theft Act 1978. The Fraud Act 2006 (FrA 2006) defines three classes of fraud: (i) by false representation; (ii) by failing to disclose information; and (iii) by abuse of position. FrA 2006, s 10 increases the maximum penalty for participating in fraudulent business carried on by a company to 10 years' imprisonment. FrA 2006, s 12 provides that where an offence under FrA 2006 was committed by a body corporate, but was carried out with the "consent or connivance" of any director, manager, secretary or officer of the body—or any person purporting to be such—then that person, as well as the company itself, is liable.

CONCERNS FOR UK BUSINESS

With increased regulation comes a greater need for companies to become more aware of their duties. Ultimately—and assuming, as seems likely, that the legal landscape will feature greater regulation—there is no substitute for due diligence and promotion of compliance. The costs of compliance are an undoubted disincentive. However, the risk of falling foul of the regulatory regime—and the consequent damage to reputation, personal or institutional, as well as potential sanctions—should provide the clearest incentive to seek to promote greater awareness and a compliance culture.

Equally, given the US drive for corporate accountability, UK companies may be positioned to take advantage of the reluctance of some businesses to create a "legal footprint" which might trigger US legal jurisdiction. Difficult though it is to structure transactions which seek to avoid US jurisdictional issues in many cases, this is by no means impossible. In a recent survey conducted by Eversheds —to be published shortly—of 530 UK senior managers and directors, 67% believed that the US/UK extradition relationship would lead to more complex trade agreements.

In the same survey, 72% of respondents believed that UK directors are facing more criminal liability than five years ago, and 71% believed that the influence of US regulation had led to an increase in litigation in the UK.

THE CORRUPTION BILL

The Corruption Bill is currently going through Parliament and is highly controversial. Once enacted, it will replace the plethora of existing statute and common law provisions to create a more workable corruption offence, as well as imposing greater prohibitions on the conduct of UK nationals and companies abroad—giving an "advantage" (the bribe) to secure "influence" (the deal).

Clause 11 of the Bill seeks to create a duty on a UK holding company to take steps to secure compliance by its foreign subsidiaries with the anti-corruption provisions of the Bill—failure to do so could lead to a term of imprisonment of up to seven years (cl 16(2)(c)).

This piece of proposed legislation needs to be viewed in the context of some of the following matters:

- There have been hardly any UK prosecutions for corruption—and increasing international criticism (right or wrong) as a result.
- The inherent difficulties in proving corruption—complex paper trails are the main feature of such investigations.
- The existence of international standards and agreements prohibiting corruption, eg the UN Convention Against Corruption and the OECD Anti-Bribery Convention.
- An obvious reluctance on the part of many domestic investigative agencies to investigate any party—other than a foreign party.
- The "realities of commerce"—most business people will say that bribes "commission payments" are a necessary lubricant for commerce in some parts of the world, and a heavy regulatory hand will damage national business interests.

DUE DILIGENCE AND GOOD GOVERNANCE

When one moves away from the headline cases such as the NatWest Three and the BAE investigation, a survey of the UK legal landscape indicates that the UK authorities have not (as yet) adopted the US-style, heavily rule-based approach to corporate regulation.

We are, however, witnessing increasing efforts on the part of the US/EU/UK authorities to expose corporate conduct to legal scrutiny—see the recent penalties imposed on British Airways in respect of fuel surcharge price-fixing with Virgin: £148m by the US Department of Justice and £121.5m by the UK Office of Fair Trading. When one views such measures together with the "ramping up" of the US Department of Justice's investigations of alleged breaches of US anti-corruption laws by foreign companies, it is clear that companies which ignore the potential for US/EU law and the recent changes in UK law to apply to their conduct do so at their peril.

Two themes emerge from an overview of the changing legal landscape:

- due diligence is vital; and
- UK companies need to take stock of their existing "good governance" frameworks and ensure they are enhanced to seek to prevent wrongdoing or evidence proper steps by the company in this regard.

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