

# Economic Crime Act Exposure: What Companies Can Expect

By **Hayley Ichilcik and Julius Handler** (November 28, 2023)

The Economic Crime and Corporate Transparency Act is part of a broad U.K. legislative package to prevent abuse of corporate structures and tackle economic crime. It received royal assent on Oct. 26.

The act is an important development for companies in considering their exposure to criminal liability for two reasons.

- It reforms how corporate criminal liability is attributed; and
- It introduces a new "failure to prevent fraud" offense.

Understandably, corporate counsel will be quick to take notice of these developments, especially in light of messaging we have seen from prosecutors.

New Serious Fraud Office director Nick Ephgrave called the act a significant boost to the agency's ability to investigate and prosecute, while the chief crown prosecutor of the Crown Prosecution Service, Andrew Penhale, noted that the new offense should result in greater care to prevent fraud before it happens.

In this article, we discuss the effect of these developments, what they mean for corporate exposure to criminal liability, whether we will now see an uptick in the number of criminal convictions, and importantly, what companies can be doing in response.

## The Effect on Corporate Criminal Liability

For the last 50 years, to hold a company criminally liable for an offense, prosecutors had to establish that the offense was committed by the directing mind and will of the company. Anything less than the highest level of management would not make the company liable.

The problem? As the government explained in a fact sheet on the identification principle for economic crime offenses, companies have become more complex.[1] Key decisions have become decentralized away from the most senior level and dispersed among multiple minds that may not be senior enough to embody the company.

The effect of the act is to attribute criminal liability to companies if a senior manager has committed a criminal offense from a long list in the act.

The act defines a senior manager as someone who plays a significant role in "the making of decisions about how the whole or a substantial part of the activities of the body corporate or (as the case may be) partnership are to be managed or organized, or the actual managing or organising of the whole or a substantial part of those activities."

Who constitutes a senior manager may well boil down to a question of substance, not form — a test that will require more than a plain reading of job titles.



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This reform is expected to come into force two months after royal assent, i.e., December.

### **What This Means for Companies' Exposure**

The intention of the act is to make it easier to hold companies criminally liable. How this translates to convictions is another matter. The government considers that this reform will only increase court cases by three at most per year but also notes that corporate prosecutions will likely be dealt with by deferred prosecution agreements.[2]

Ultimately, whether the reform will mean an increase in corporate criminal convictions depends on who exactly a senior manager is and the evidential challenges that prosecutors might face in showing it.

### **What Should Companies Do?**

In the first instance, it would be prudent for companies to identify who might be considered a senior manager and ensure that adequate training and risk prevention measures are in place.

This is easier said than done and might well require a specially tailored approach to take into account three factors.

#### ***1. Senior Manager Test***

Given that the senior manager test will likely require a fact-specific test of what the individual in question does, the following questions might well be relevant:

- What are their responsibilities and roles?
- What influence do they exert within the organization?
- What is their decision-making authority, both in theory and in practice?
- Even if they don't have a centralized headquarter function, do they nevertheless have an operational management role?

#### ***2. The Breadth of Offenses in Scope***

We are dealing with a wide range of offenses, and prevention and risk management measures will need to be targeted to prevent the offense in question.

#### ***3. Jurisdiction***

If the offense takes place outside the U.K., Section 196(3) of the act provides that the organization is only guilty of the offense if "it carried out the acts that constituted that

offence (in the location where the acts took place)."

What this means will depend on the offense in question. For example, a U.K. company could be liable for a breach of U.K. sanctions if its senior manager, a U.K. national, committed a breach outside the U.K.

### **Failure to Prevent Fraud**

The failure to prevent fraud offense imposes liability on companies for failure to prevent a wide range of fraud offenses committed by all employees and agents, including:

- False representation;
- Obtaining services dishonestly;
- Participating in fraudulent business;
- False accounting;
- False statements by company directors;
- Fraudulent trading; and
- Cheating the public revenue.

However, if a company can prove that it had reasonable precautions in place to prevent fraud or that it was reasonable to have the precautions in place that it did, it will not be liable.

The government is obliged by the act to issue guidance on reasonable precautions before the offense comes into force. This offense might not come into force before 2025 given the government's plan to consult on what would constitute reasonable procedures for the purposes of the offense in 2024.

Unlike the senior manager test, which applies to all companies, the failure to prevent fraud offense will apply only to larger companies that have at least two of the following:

- More than 250 employees;
- More than £36 million (\$45 million) turnover; or
- More than £18 million in total assets.

Furthermore, if a fraud is perpetrated against the company, the company will not be liable if it is a victim of the fraud. However, it appears to be the case that if a person committed the fraud against the company with the intention to benefit the company, the company can still be liable, even if the company did not in fact gain any benefit.

Two specific changes were made to the failure to prevent fraud offense during its passage through Parliament.

First, the House of Commons decided that the failure to prevent fraud offense would not cover failure to prevent money laundering.

Second, after debate with the House of Lords on the issue, the House of Commons succeeded in ensuring that the offense would only apply to larger companies as opposed to all companies. This was on the basis that, as noted by Business Minister Kevin Hollinrake, larger companies have the capacity, human resources and risk compliance departments to

mitigate these kinds of risks while smaller organizations would incur significant costs in taking the appropriate measures required in response to the new offense.[3]

## **What Companies Should Do**

### ***Identify the Offending Behaviors***

The first question will be: What behaviors are within the scope of the offense? Following the act's consultation process, lawmakers cited dishonest sales practices, hiding important information from consumers or investors, or dishonest practices in financial markets as examples of the type of behavior intended to be caught by the offense.[4]

To ensure a carefully tailored approach to the offense, the exercise not only requires careful legal analysis of the offense in question but also an assessment of the risk factors for fraud in the specific environment the company operates in.

Relevant questions could include: Are there complex supply chains involved, involving multiple contracts? Are there pressing deadlines or incentives that mean potentially fraudulent behaviors are practiced? Are there large costs involved in company transactions that may allow fraud to be hidden?

### ***For Multinational Companies, Consider Extraterritorial Issues***

A complicating factor is potential extraterritorial considerations. The government fact sheet states that if an employee commits fraud under U.K. law, or is targeting U.K. victims, the employer could be prosecuted, even if the organization — and the employee — are based overseas.

It appears that a non-U.K. company could be prosecuted for failing to prevent its non-U.K. employees from committing fraud outside the U.K. if there are U.K. victims of that fraud.

### ***Reasonable Procedures***

Practically speaking, and subject to the guidance the government is obliged to issue regarding what constitutes reasonable procedures, it might be sensible for companies to consider six steps.

#### *1. Tone*

Ensure the right tone from the top, demonstrating the company's ethical behavior and commitment to legal standards with clear internal communications, making resources available for employees and, where relevant, seeking the appropriate functional support in decision making.

#### *2. Impact Assessments*

Conduct impact assessments as to where fraud risks come from by:

- Identifying the potential fraud scenarios relevant to the company and assessing the company's vulnerabilities in its existing control systems;

- Determining the impact such risks have on financials, operations, reputation and legal compliance, and rank such risks based on their potential impact; and
- Developing mitigation strategies to reduce such vulnerabilities and strengthen controls, which should be regularly reviewed and benefit from engagement with relevant stakeholders, such as internal audit, finance and IT.

### *3. Targeted Training*

Implement targeted training on fraud prevention to those operating in areas of the business that might be vulnerable to risk in the area.

### *4. Business Terms*

Review terms of the business with third parties to consider whether conflicts of interests could arise, which might lead to instances where third parties make decisions in their interest, leading to company employees becoming involved in dishonest sales practices or misusing their position by providing unauthorized access to confidential company information.

### *5. Whistleblowing*

Make sure that whistleblowing mechanisms allow instances of fraud to be flagged by encouraging reporting and making it clear the type of behaviors that might engage the fraud offenses, e.g., with examples bespoke to the business that are accessible to employees.

### *6. Company Policies*

More generally, revisit company policies and standards to ensure that they cover the relevant fraud offenses engaged.

## **Conclusion**

Prosecutors and the government have welcomed the act with fanfare, but there are questions as to whether this will result in an uptick in convictions or deferred prosecution agreements.

Specifically, regarding the senior manager test, as noted there may be evidential challenges in identifying senior managers, especially in the context of prosecuting large companies that have complex reporting matrices and decision-making processes.

Indeed, as Vernon Coaker remarked in the House of Lords, although the act is an important step forward, if the improved laws are not enforced, they will not be as valuable as they should be.[5] We might expect that enforcement agencies feel the pressure to make use of this reform.

Unlike the U.K. Bribery Act, the difficulty for corporate counsel is that these two developments concern a large number of underlying economic crimes and fraud offenses,

each requiring a different legal analysis.

How these offenses manifest and present themselves will depend on the business of the company and the environment it operates in.

Addressing the impact of this will therefore likely require a holistic view of legal and compliance risk, bespoke to the company's commercial position. This would not seem to be an easy task for corporate counsel.

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[1] <https://www.gov.uk/government/publications/economic-crime-and-corporate-transparency-bill-2022-factsheets/factsheet-identification-principle-for-economic-crime-offences>.

[2] [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1163432/5\\_IDD\\_Impact\\_Assessment.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1163432/5_IDD_Impact_Assessment.pdf).

[3] <https://hansard.parliament.uk/commons/2023-09-13/debates/6B54D16C-EB32-4B94-A02C-D1128422C107/EconomicCrimeAndCorporateTransparencyBill>.

[4] <https://www.gov.uk/government/publications/economic-crime-and-corporate-transparency-bill-2022-factsheets/factsheet-failure-to-prevent-fraud-offence>.

[5] <https://hansard.parliament.uk/lords/2023-10-25/debates/1C871E84-626C-4961-96BE-AFCFF1366EE6/EconomicCrimeAndCorporateTransparencyBill>.