

“Following the success of our first edition this is now our second Fraud Bulletin. I would like to thank both Tim Slater of Grant Thornton UK LLP and Ben Summers of Peters & Peters for their excellent contributions to this publication”.

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Contents:

- 1 – 2 THE AFTERMATH OF FRAUD by Tim Slater, Grant Thornton UK LLP
- 3 - 4 A LESS DRACONIAN APPROACH TO CONFISCATION? by Gareth Munday
- 4 BACK TO THE FUTURE: REVITALISING THE SFO
- 5 – 7 THE REGULATORY ENFORCEMENT AND SANCTIONS ACT 2008 by Ben Summers, Partner at Peters & Peters
- 8 – 9 A BRIDGE OVER TROUBLED WATER? by James Thacker
- 10 – 11 WHEN IS PROPERTY CRIMINAL PROPERTY? by Benedict Rogers
- 12 BAE REVISITED by Philip Henry

THE AFTERMATH OF FRAUD - accessing the deep pockets

When fraud hits a company, the questions start: how could this have happened? Why did no-one spot it? Where were the auditors? In most cases, the missing money cannot be recovered in full from the fraudster (who is often a director or officer of the company), so this last question takes on added significance: auditors are required to have professional indemnity insurance and are often substantial organisations in their own right. Can we sue them?

In this article I examine the relative responsibilities of directors and auditors for the prevention and detection of fraud, then discuss some practical issues and recent developments.

Directors' responsibilities

Directors have a responsibility under the Companies Act 2006 to “exercise reasonable care, skill and diligence” and auditing standards explain that “the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and with management”. In most companies this will be the board of directors.

Many companies include a statement of directors' responsibilities, including those in relation to fraud, in their financial statements. Auditors require management to acknowledge, usually in a written letter (the so called “letter of representation”), its responsibility for the design and implementation of internal controls to

prevent and detect error. Consequently there should be no misunderstanding that an audit relieves the directors of their responsibilities.

Auditors' responsibilities

Although, as has been seen, directors bear the primary responsibility for prevention and detection of fraud, the auditors are not absolved of all responsibility. Far from it. They must comply with professional standards which require them, amongst other things, to

- identify and assess the risks of material misstatement due to fraud, and evaluate the company's controls
- discuss, as a team, the susceptibility of a company's financial statement to misstatement due to fraud
- determine responses to address the assessed risks
- consider whether an identified misstatement may be indicative of fraud.
- maintain an attitude of professional scepticism throughout the audit
- obtain reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

The purpose of the audit

Auditors often complain that there is an “expectation gap” in relation to audits, but what do they mean by this? Basically, there sometimes appears to be a perception by the general public, and even sometimes by directors, that if the auditors issue an unqualified audit report then they are certifying that the financial statements are “right”. This is simply not true. The wording of a standard audit report speaks

continued on page 2

of obtaining “reasonable assurance” that the financial statements are free of “material misstatement” and give “a true and fair view” (not, it should be noted the true and fair view). It explains that evidence is examined “on a test basis”.

In other words, an audit does not give absolute assurance over the financial statements, only “reasonable assurance”. Furthermore, the financial statements could contain errors which the auditor is aware of but considers not to be significant enough to prevent the financial statements taken as a whole from giving a true and fair view.

Indeed, auditors may act to the standard expected of a reasonably competent auditor in accordance with auditing standards (the test usually applied in audit negligence cases) and still fail to identify a fraud for a range of reasons from it being too small to register in the context of the company’s size, to simple bad luck where a sample selected for testing happens not to include any fraudulent items.

The auditors’ responsibilities are not limited to sample testing, and their assessment of the company’s systems should help identify the risk of fraud, however a determined and clever fraudster may circumvent even the most rigorous of systems.

Causation

If a company suffers a fraud and seeks to recover some of the loss from its auditors, it is not enough for it to demonstrate that its auditors were negligent. The company must also show that the negligence complained of led to the loss, which, in many cases, can be hard to do. For example, the auditors may be found to have been negligent in failing to ask questions about a transaction, but if in fact that transaction was not part of the fraud they would not have identified the wrongdoing even had they carried out the most searching investigation.

What you can expect from the auditors

Auditors issue an engagement letter for their work, which sets out the contractual basis on which they will undertake it. This will typically include a clause exempting individual partners and staff from personal liability and may, since 6 April 2008, seek to agree a limitation of liability.

The engagement letter usually explains the directors’ responsibilities and that the auditor will review the company’s accounting systems and report any weaknesses found to management and those charged with governance, and explains that the audit is not designed to identify all significant weaknesses in the company’s systems.

At the end of the audit, the auditors report back (typically to the board of directors and, in particular, the audit committee, where one exists) on such weaknesses and errors as they have found, including questions regarding management integrity. Such reports are normally in the form of a “management letter”.

The auditors will usually also review the matters reported on in the previous year and give an update on their status. It is not sufficient for auditors to report a material weakness in controls

once - if it persists they must continue to report it each year, and consider the implications of management’s failure to address the issue.

Interaction between directors’ and auditors’ responsibilities - contributory negligence

If it is right that the primary responsibility lies with the directors and cannot be delegated to the auditor, it seems almost impossible to conceive of circumstances in which auditors negligently fail to uncover a fraud but the directors had not also been negligent. Such contributory negligence reduces the auditors’ liability in proportion to the relative negligence of auditor and management, and can have a major impact on the damages awarded. For example in the case of Barings, Mr Justice Evans-Lombe reduced the amount payable by the auditor, Deloitte, by 80% in one respect.

Fraud by the controlling mind of a company

In the recent case of *Stone and Rolls Limited (in liquidation) v Moore Stephens [2008] EWCA Civ 644* the Court of Appeal held that a fraud carried out by an owner-manager of a company, who was found to be its “controlling mind”, was attributable to that company; and that as a matter of public policy the company could therefore not sue its auditors for failing to prevent a fraud which it had itself committed. Consequently, the case was struck out without the auditor’s work ever even being considered. This has an interesting and perhaps unintended consequence: it would appear that, where fraud is committed by someone who is the sole directing mind of a company, the auditors are not financially answerable to the company, no matter how negligent they may have been, although it is thought that permission to appeal will be sought from the House of Lords in *Stone and Rolls Limited*. It may be that only the auditors’ regulators can hold them to account.

Summary and conclusions

Auditors are a tempting target for a company that has been the victim of fraud. They are likely to have the wherewithal to satisfy an award, and it is natural, when in distress, to look for someone to blame. However, a company should seek cool-headed professional advice before rushing into action. First, the auditors may not have been negligent at all. Secondly, if they were negligent, that negligence might not have caused the loss. Thirdly, there is likely to be significant contributory negligence which will affect the value of any award - and this contributory negligence will aired in public!

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Tim Slater

A LESS DRACONIAN APPROACH TO CONFISCATION?

Earlier this year the House of Lords delivered their opinion in *R v May* [2008] UKHL 28 and the related appeals of *R v Jennings* [2008] UKHL 29 and *R v Green* [2008] UKHL 30. It was widely believed at the time that these cases would assist the prosecution, but is that really the case?

May, Jennings & Green

In *May* the appellant had pleaded guilty to being party to a conspiracy to cheat the Revenue. May's part in this fraud was during its last two phases when the conspiracy obtained some £4,439,533. The fraud itself resulted in a loss to public funds of around £11,000,000. At first instance the trial judge wrongly reduced the benefit figure of May by monies recovered but set the confiscation on the basis that the appellant's benefit figure should be calculated on the amount obtained by the conspiracy during the appellant's participation, thereby allowing for multiple recovery from all conspirators. On appeal it was contended that the benefit figure should have been apportioned between the defendants.

In *Jennings* the appellant was employed in a company which was found to be created for the sole purpose of advance fee frauds. A restraint order was made preventing the appellant from disposing of or diminishing the value of any of his assets. The appeal was made on the basis that the appellant's benefit should not have been determined as the total amount obtained through the advance fee fraud but rather the appellant's salary during that period.

In *Green* the appellant was the principle driving mind of a conspiracy to supply class A and B drugs and then launder the proceeds. The appeal was on the basis that benefit should be apportioned between the conspirators, such that the appellant's benefit figure should be reduced by the sum of the monies retained by the co-conspirators.

All three appeals were dismissed. Although all three appeals dealt with the law pre the Proceeds of Crime Act 2002 ("POCA"), the relevant sections of those acts considered within the appeals mirror those of section 76(4), (5) and (6) of POCA, and so have cross applicability.

Principles of confiscation

The committee took the opportunity to re-state the principles of confiscation:

The rationale of the confiscation regime is that the defendant is deprived of what he has gained or its equivalent. He cannot, and should not, be deprived of what he has never obtained or its equivalent, because that is a fine.

The House of Lords went on to set out the three questions to be applied in confiscation proceedings.

- Whether the defendant has obtained a benefit from or in connection with the relevant criminal conduct, be that general criminal conduct or particular criminal conduct?
- What is the value of that benefit?
- What sum is recoverable from the defendant?

Determining 'benefit'

The House of Lords confirmed that:

- A benefit is not dependent upon there being a profit from the relevant criminal conduct.
- Benefit includes payments made to third parties on behalf of defendant's as well as property received jointly.
- Benefit does not mean property retained by a defendant, but includes property obtained and passed on to others within an offence.
- The value of benefit includes the value of property obtained jointly.

Consequently there need be no apportionment between defendants in confiscation proceedings. It follows that a number of defendants may be liable to pay under a confiscation order the same or virtually the same sum in respect of the same property; multiple recovery is not only possible but properly pursuable by prosecuting authorities. It is understandable why these appeals have been seen as simplifying the issues for both the court and prosecutor. However that view is to overlook the detail of the committee's three opinions, which may in fact result in a move away from the previously stated uncompromising and draconian approach of and to the legislation.

Prior to *May*, *Jennings* and *Green*, when considering whether a defendant had obtained a benefit from his relevant criminal conduct a trial judge would fall back on the formula provided by Laws LJ in *J v CPS* [2005] EWCA Civ 746, that:

"What remains to be said about the meaning of the word 'obtain' ...? Clearly it does not mean 'retain' or 'keep'. But no less clearly, in my judgment, it contemplates that the defendant in question should have been instrumental in getting the property out of the crime. His acts must have been a cause of that being done. Not necessarily the only cause: there may, plainly, be other actors playing their parts. All that is required is that the defendant's acts should have contributed, to a non-trivial (that is, not de minimis) extent, to the getting of the property. This is no more than an instance of the common law's conventional approach to questions of causation."

continued on page 4

In *Jennings* the House of Lords cast doubt on that formula stating that:

The committee does not, with respect, find the formulation of Laws LJ ... to be helpful or entirely accurate. A person's acts may contribute significantly to property (as defined in the Act) being obtained without his obtaining it. But under section 71(4) a person benefits from an offence if he obtains property as a result of or in connection with its commission, and his benefit is the value of the property so obtained, which must be read as meaning "obtained by him".

In re-stating that the issue of benefit is a question of fact, and whether the particular defendant, as a matter of fact, obtained a benefit the House of Lords has opened up arguments such as those raised in *R v Grainger* [2008] EWCA Crim 2506.

In *Grainger* the appellant was convicted with others of fraudulent trading. As the financial director of a company he was said to be acting in a joint enterprise with the major shareholders to defraud banks supplying credit to the company. In the confiscation proceedings the prosecutor invited the court to say that since all the defendants were parties to a joint enterprise, all were to be treated as having benefited equally from it and the benefit was the money obtained fraudulently from the banks. However applying *May* the Court of Appeal found that the payments were made to the company and although the appellant was instrumental in causing those payments to be made it did not follow that he had obtained a direct benefit in the amount of those payments. Further that although the trial judge had found as a matter of fact that the appellant had joint control of the company with others and had joint and fully active responsibility, that was not an adequate basis for finding that the monies paid to the company were obtained by the appellant.

Those prosecuting and determining confiscation proceedings can therefore expect more detailed arguments on what amounts to obtaining a benefit. A simple broad brushed approach of determining benefit on a joint enterprise basis may well now not find favour.

Although cited as putting to bed the idea of apportionment in truth the opinion of the committee does not in fact close the door on apportionment, at paragraph 45 of *May*:

There might be circumstances in which orders for the full amount against several defendants might be disproportionate and contrary to article 1 of the First Protocol, and in such cases an apportionment approach might be adopted

Change in direction

Further signs of a change in direction in confiscation proceedings can be seen in cases such as *R v Shabir* [2008] EWCA Crim 1809. In *Shabir* the appellant had inflated 6 otherwise legitimate invoices by an amount of £464, the total paid out on those invoices was £179,731.19. As he had been indicted on the full amount of the invoices and was subject to the assumptions under the POCA he was held to have benefited in the sum of £212,464.17. The Court of Appeal held that (a) despite *May* (b) despite the assumptions under the POCA and (c) despite no bad faith on the part of the prosecuting authority, the confiscation proceedings were so oppressive that they amounted to an abuse of process. The confiscation order was quashed and replaced with a compensation order for £464.

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Gareth Munday

BACK TO THE FUTURE: Revitalising the SFO

As a result of public concern about the performance of the Serious Fraud Office ["SFO"] the last Attorney-General, Lord Goldsmith QC, and the last director of the SFO, Robert Wardle, commissioned a very experienced New York fraud prosecutor to investigate and report on the workings of the SFO, particularly by comparison with City and federal prosecutors in New York. Ms Jessica de Grazia undertook an extensive analysis and in June this year she published a report making recommendations that covered the internal workings of the SFO in detail, as well as several external factors that have impacted the effective operation of the SFO.

On 13th October 2008 the British Institute of International and Comparative Law hosted a seminar at its headquarters in Russell Square which was attended by a distinguished group of professional and academic lawyers. The meeting was chaired by His Honour Judge Geoffrey Rivlin QC. There were four platform speakers. Ms de Grazia explained the essence of her findings and summarised three of her principal recommendations. Richard Alderman, the new director of the

SFO eloquently explained his emerging vision for the future of the Office. David Kirk, head of the CPS fraud unit, offered a valuable contribution from his unrivalled experience as a prosecutor and defender. Andrew Baillie QC of 9 Gough Square was invited to add some thoughts from the perspective of the independent Bar.

Ms de Grazia reminded the audience that the recent conviction rate of the SFO has been 61% while their New York equivalents had conviction rates of 90% or more. She had made 34 recommendations in her report but concentrated on just three. First, the SFO was wasting a huge amount of resources following the Attorney-General's guidelines on disclosure. It should be able, in appropriate cases, to follow its previous approach and to offer the defence "the keys to the warehouse". Secondly the SFO should increasingly use in-house advocates. Thirdly, plea negotiation at an early stage should be allowed and might become widespread. More than one view was expressed on each of these topics in the course of a lively discussion.

The Regulatory Enforcement and Sanctions Act 2008 - is less the new more?

Following the publication of the Hampton Review in 2005 and the Macrory Review in 2006 the Government published the draft Regulatory Enforcement and Sanctions Bill. Having received Royal Assent on 21 July 2008, parts 1, 3 and 4 of the Regulatory Enforcement and Sanctions Act ("the RESA") came into force on 1 October 2008 and Part 2 will come into force on 6 April 2009. Its aim was to "provide consistent enforcement and increase the effectiveness of risk-based regulation across the country and ease the burden for business".

Introduction to the RESA

For practitioners in the field of business regulation and enforcement, it is part 3 of the RESA which is of most interest, but it is worth noting the contents of parts 1, 2 and 4 before looking more closely at part 3.

Part 1: the LBRO

Part 1 of the RESA provides that the rather Orwellian sounding Local Better Regulation Office (for England & Wales) is to be established as a statutory body to promote greater adherence to principles of better regulation and coordination between local authorities. Its aim is to assist local authorities to regulate in a way which is proportionate, accountable, consistent, transparent and targeted.

Part 2: Coordination of Regulatory Enforcement

Voluntary schemes establishing 'Home Authority' and 'Lead Authority' agreements between regulators were judged to have resulted in a number of benefits. However, the agreements were not consistently applied, nor were they as wide-ranging as the Hampton Review considered they could be. Consequently, the RESA outlines a statutory Primary Authority Partnership Scheme spanning the UK, under which a local authority registers its responsibility for a particular business or organisation.

Part 4: Regulatory Burdens

This Part imposes a duty upon regulators to review their functions, not to impose unnecessary burdens and to remove any such burdens wherever possible. The duty applies to Ofgem, the Office of Fair Trading, the Office of Rail Regulation, Postcomm and Ofwat. The duty can be extended to other regulators by order if it is felt to be desirable to promote the better regulation agenda.

Part 3: New Civil Sanctions

Part 3 of the RESA represents a significant shift in regulatory emphasis away from prosecution as the key compliance tool. Instead regulators now have a more sophisticated 'toolkit' of sanctions which can be imposed directly by the regulator without any judicial intervention.

There are four categories of civil sanction:

Fixed Monetary Penalty ("FMP")

A regulator can impose a FMP where it is satisfied beyond reasonable doubt that a relevant offence has been committed. These are low level fines which may differ according to type of business e.g. sole trader or limited company. They are intended to be used for minor regulatory non-compliance and 'will usually be capped at a maximum of £5,000'. Before imposing a FMP the regulator must serve a notice of intent setting out (i) the grounds for imposing the penalty, (ii) providing the recipient with an opportunity to make representations and to raise objections, and (iii) details of the applicable time limits. There may also be early payment discounts of the kind operated for example in parking matters. There will also be a right of appeal on the basis that the penalty was based on an error of fact, is wrong in law or is unreasonable. Unpaid fines will be enforced through the civil courts.

Discretionary Requirements

A package of sanctions including any combination of the following elements:

- a Variable Monetary Penalty ("VMP") to be determined by the regulator, set at a level that removes any financial advantage gained by non-compliance;
- a Compliance Requirement which can be used to ensure that steps are taken to rectify a compliance breach;
- a Restoration Requirement which can be used to ensure a business deals with the consequences of an offence

Again a notice of intent must be served by the regulator and there is a right of appeal. Enforcement will be through the civil courts.

Stop Notices

Where a business served with a notice is already carrying on an activity the notice will prohibit the activity until any requirements specified in the notice have been complied with. The regulator

continued on page 6

must reasonably believe, before issuing a stop notice, that the activity presents a significant risk of serious harm to human health, the environment (including animals and plants) or the financial interests of consumers and is, or is likely to be, an offence. A failure to comply with a stop notice will be a criminal offence. There will be a right of appeal and provision for compensation for wrongly imposed stop notices.

- **Enforcement undertakings**

These are agreements made between a business and a regulator whereby the business agrees to undertake specific actions e.g. to ensure a non-compliant activity will not recur, or payment of compensation to those affected by the breach. These undertakings may be used in cases where the business itself has brought the issue to the attention of the regulator. A regulator is not obliged to accept the offer of an undertaking from a business. A breach of an undertaking may result in an alternative sanction such as the service of a compliance notice or criminal prosecution.

Which regulators have been given extended powers?

Not all regulators have been given the power to impose the civil sanctions set out above, and of those that have, the sanctions do not apply to all regulatory offences. Rather, the RESA provides that the enhanced regulatory powers will be granted to three categories of regulators.

First, those 27 regulators listed in Schedule 5 to the RESA including the OFT, the Competition Commission, the Financial Services Authority, the Health & Safety Executive, the Information Commissioner, the Gambling Commission and the Environment Agency.

Secondly, those regulatory bodies that enforce offences contained in any Act listed in Schedule 6. Schedule 6 offences are broadly those regulatory provisions enforced by the regulators listed in Schedule 5, but the relevant Act allows other bodies to enforce its statutory objectives.

Thirdly those that enforce offences in secondary legislation made under enactments listed in Schedule 7. These provisions extended the statutory objectives yet further.

How are these powers likely to be used?

On 20 March 2008, the National Audit Office, in conjunction with the Better Regulation Executive, published reports ("the NAO Reports") on how the 'big five' regulators (the FSA, OFT, HSE, Food Standards Agency and Environment Agency) were implementing the Hampton recommendations.

The Financial Services Authority

The FSA has various civil, criminal and disciplinary powers available to it already. The majority of the FSA's enforcement powers are derived from the Financial Services and Markets Act 2000 ("FSMA"). Whilst the FSA has an extensive range of sanctions available to it, the NAO Reports note that it is somewhat disinclined to employ them. Given their existing powers and apparent predisposition for expedient methods of case disposal, use of enforcement

undertakings (particularly in conjunction with existing provisions including Skilled Person Reports) under the RESA could prove popular with the FSA. Enforcement undertakings are flexible enough to cover a variety of situations and so the mechanism may allow the FSA to agree to more innovative settlement proposals,

However, recent statements by the current Chairman of the FSA, Lord Adair Turner, suggests that the FSA may become more heavy-handed in its approach and the days of 'light-touch' regulation are over. If this proves to be true, it is likely that the FSA will increasingly rely on its existing powers to impose penalties under FSMA, as these enable the FSA to levy fines of an amount that it deems 'appropriate'.

The Office of Fair Trading

Prior to the passing of the RESA, the OFT was granted new powers in the form of the Consumer Credit Act 2006 ("CCA 2006"), which amended the Consumer Credit Act 1974 ("CCA 1974") from 6 April 2008. Most notably, under s.33A CCA 1974 the OFT can now issue notices requiring licensees to take certain actions, or cease taking certain actions to address matters with which the OFT is dissatisfied. If the licensee fails to comply with this notice, under s.39A CCA 1974, the OFT can issue a penalty notice requiring the licensee to pay a fine of up to £50,000.

Prior to the implementation of the CCA 2006, the primary consumer protection tool used by the OFT was Part 8 of the Enterprise Act 2002 'the 2002 Act'. All enforcement actions under the 2002 Act commence with a consultation between the OFT and the relevant business, which usually takes the form of undertakings. In the NAO Reports, the OFT identified that, although undertakings were effective in achieving the desired outcome in most cases, difficulties arose if the undertaking was breached. In this event, as would be the case for default under the enforcement undertaking provisions of the RESA, the OFT must resort to court action.

Where the infringement is triable summarily only, if the infringing party is a licensee under the CCA 1974, it is difficult to see why the OFT would use the new powers under the RESA. On breach of an undertaking, the OFT would have to pursue the defaulter in court for the original offence under the RESA, whereas a licensee in breach of a s.33A notice (served instead of an undertaking), could be fined up to £50,000 by way of a fixed penalty.

The Health & Safety Executive

The HSE's main sector-specific tool is the Health and Safety at Work Act 1974 ("HSWA"). Under HSWA, the HSE is able to issue improvement and prohibition notices. If a breach of an improvement or prohibition notice occurs, the HSE may prosecute. However, the decision as to liability and the imposition of any fine rests with the court.

Due to its existing and established notice mechanisms, the HSE's use of compliance, restoration and stop notices under the RESA may be minimal. However, given that it has no direct remit to fine persons in contravention of statutory provisions without recourse to the courts, the HSE could find the fixed and variable monetary penalties under the RESA a useful stepping stone between the issue of notices and prosecution.



The Food Standards Agency

The Food Standards Act 1999 ("FSA 1999") enables the Food Standards Agency to oversee local authority food safety enforcement. Local enforcement officers and the Food Standards Agency ("enforcers") have powers under the Food Hygiene (England) Regulations 2006 ("the Regulations") and the Food Safety Act 1990 ("FSA 1990") to issue improvement, prohibition and emergency prohibition notices. The improvement notice is very similar in format to those issued by the HSE in respect of suspected infringements. However, unlike the HSE, service of a prohibition notice simply precedes an application to the court for a Prohibition Order.

Under the Regulations, a remedial action notice may be issued, which may prohibit the use of any equipment or any part of the establishment, impose conditions on the carrying out of a process, prohibit the carrying out of a process, or require the rate of operation to be reduced. A remedial action notice should state why it is being served. Prior to the issue of an improvement notice, the enforcer may send the infringing party a written warning. The NAO Reports state that written warnings account for 96% of all enforcement activity.

Enforcers also have the power to require food businesses to withdraw or recall food that is deemed unsafe. According to the NAO Reports, this mechanism, which has the character of a sanction, is one of the enforcers' most valuable means of enforcement, as the costs of recall or withdrawal can cause a greater monetary loss than a fine and recall or withdrawal is often also accompanied by damage to reputation and a loss in consumer confidence.

In light of the above, the NAO Reports concluded that the penalties possessed by the Food Standards Agency were adequate; a view shared by the regulator. Taking this into account alongside the statistics in respect of enforcement cited above, which seem to indicate a tendency towards cooperation rather than punishment, it is open to question whether the Food Standards Agency will use, or indeed require, extended sanctions under the RESA.

The Environment Agency

The powers of the Environment Agency ("EA") include enforcement and works notices, prohibition notices, the suspension, revocation or variation of licence conditions and the recovery of the costs of remedial works carried out. For a limited range of offences (such as the failure to keep and retain descriptions of waste and transfer notes under s.34A of the Environmental Protection Act 1990), the EA or its officers may impose fixed penalties which are usually set between £50 and £300.

In order to impose punitive sanctions on offenders where the fixed penalty regime does not apply, or is insufficient, the EA must pursue the matter in court. Whilst the EA prosecutes offenders (in 2007, they prosecuted more companies than ever before), the NAO Reports acknowledge that their sanctioning powers are not sufficiently flexible and they would benefit from administrative sanctions where, for example, there is a technical breach of permit conditions and a prosecution would be disproportionate. Likewise, the NAO Reports reflect the EA's dissatisfaction with the level of fines imposed by the courts.

The EA has stated its intention to make use of sanctions under the RESA in situations where companies have not willfully harmed the environment, but have neglected their environmental obligations. Taking into consideration the EA's views on fines imposed by the courts and the EA's lack of flexibility in sanctioning, it can be expected that use of FMPs and VMPs under the RESA may become common.

Conclusion

The Bill received criticism from a number of sources, in particular from the House of Lords Constitution Committee. Criticism focused on the extent to which it is constitutionally appropriate for regulatory authorities, rather than the courts, to make determinations as to whether a person has committed a criminal offence and to impose unlimited financial penalties.

In addition there is a question mark over whether the procedural protections (which include the application of the criminal standard of proof) match up to the minimum standards of procedural fairness that a person accused of a criminal offence ought to have. There is also a potential for a lack of consistency across the UK as parts of the RESA extend to England and Wales only. Is this a missed opportunity for regulatory simplification and should not arrangements be consistent across the UK?

Whilst the extended sanctioning powers under the RESA will undoubtedly benefit some agencies, for other agencies whose sanctioning scheme is well developed (for example the FSA) they appear somewhat redundant. Moreover, in respect of certain organisations, including the Food Standards Agency, it must be asked why, if additional powers are not required, have they been provided? Is the RESA, rather than simplifying matters, complicating them yet further?

The Government promoted the Bill on the basis that it would reduce the cost of administering regulation, rationalise inspection and enforcement agencies and at the same time efficiently tackle businesses that flout their regulatory obligations. While much of the impact of the RESA will only become apparent once it is clear how it is to be applied by individual regulators and for which particular offences, businesses would be wise to keep this new and potentially very significant piece of legislation in their sights. We may yet see the dawn of a new regulatory era.

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Ben Summers

A BRIDGE OVER TROUBLED WATER?

Has the Court of Appeal in *R v Mote* [2007] EWCA 3131 and *R v Laku* [2008] EWCA Crim 1745 now provided clear guidance on how to draft charges in benefit fraud cases?

Prior to *R v Graham and Whatley* [2004] EWCA 2755 a person who had completed benefit forms fraudulently (whether to claim Income Support or Incapacity benefit from the Department of Work and Pensions (“DWP”) or Housing and Council Tax benefit from the local authority) would usually be charged with false accounting contrary to section 17(1)(a) of the Theft Act 1968 or, if after the commencement date of 1st July 1997, with dishonestly making a false representation contrary to section 111A(1)(a) of the Social Security Administration Act 1992 (“the 1992 Act”). If the original claim forms could not be located then a defendant would have been charged with the same offence on the basis of declarations made on review forms.

Intervention by the Court of Appeal provided a headache for prosecutors

In *Whatley* the appellant had claimed sickness benefit from 1994. In 1997 he completed a review form declaring that he was not working and had no income. The Crown's case was in fact he had worked as a street trader from May 1997 to July 2001, and as a casual street trader since 1992. He had not declared such work and the income that it generated to the DWP. The Crown adduced evidence to show that the appellant was seen by trading inspectors serving people and paying over his rent. In a number of voluntary statements, not made under caution, the appellant maintained that he had never worked at the market. He said that others ran his stall and that he had not received any financial benefit from it.

He was charged on count 1 with false accounting which related to declarations made on a review form completed in May 1997. Counts 2 to 11 alleged further offences of falsifying documents required for an accounting purpose, namely paid orders that the appellant had signed between August 2000 and July 2001 declaring no change. The appellant was sentenced to a total of 30 months imprisonment.

The Crown adduced evidence that the total benefit received by the appellant during the period was in excess of £90,000. The learned judge approached the sentencing exercise on the basis that there was no dispute that the sum in excess of £90,000 received by way of benefits could all be traced back, as he put it, to the fraudulent review form completed in 1997.

Mr. Justice Owen stated:

“In our judgment, [the attempt by the judge at first instance that the whole £90,000 could be traced back to the fraudulent A2 Review Form] was misconceived for two reasons. First, although

*it was not conceded that a total sum in excess of £90,000 had been received by way of benefits during the relevant period, it was conceded that the appellant had not been entitled to benefits throughout that period. On the contrary, it was the defence case that he had not been working. The highest that it could be put was that the Crown was able to satisfy the jury that the appellant had not been entitled to receive benefit on the dates specified in the counts in the indictment. Secondly, the A2 Review Form was a declaration that at that date the appellant was not working. It was not, and could not be, a declaration as to the future. That is no doubt why the system for claiming benefit requires the recipient to sign a declaration in a benefit book on each occasion that he or she receives benefit; hence counts 2 to 11 of the indictment. It follows that, in our judgment, the valiant attempt by the learned judge to circumvent the decisions in *Clark and Canavan* was misconceived and that he erred in imposing a sentence on count 1 intended to reflect the receipt of over £90,000 by dishonest means. The appellant stood to be sentenced for offences of fraud involving a total of approximately £3,100.”*

The Divisional Court comes to the rescue but more questions are asked than answered

Following on from the Court of Appeal's judgment in *Whatley*, in order for prosecutors to draft charges that covered the full extent of a defendant's criminality, the defendant either had to be indicted on the original claim form and/or indicted with as many review forms and giro-cheques as possible or all the individual payments made to the defendant were listed for the defendant to (hopefully) accept in a TIC schedule. As those of us who prosecute for the DWP and local authorities recognise this would be a mammoth task. The defendant could refuse to sign a TIC schedule without



any real fear of being prosecuted for the offences. The alternative, which prosecutors believed provided a salvation, was to indict a defendant with a single charge of dishonestly failing to notify a change of circumstances promptly.

Subsection 111A (1A) was inserted into the 1992 Act by section 16 of the Social Security Fraud Act 2001 and came into force on 18 October 2001. Subsection 111A (1A) replaced an earlier provision, inserted into the 1992 Act by the Social Security Administration (Fraud) Act 1997, which made it an offence to ‘fail to notify a change of circumstances which regulations under this Act require him to notify’. This provision had never had any effect, for no regulations requiring notification of a change of circumstances were ever made under the Act.

Problems began in cases where the relevant change of circumstance occurred prior to section 111A (1A) coming into force. Prosecutors felt relieved when the Divisional Court in *Parry v Halton Magistrates’ Court and the Department of Work and Pensions* [2005] EWHC (Admin) 1486 decided that a defendant could be indicted under s.111A (1A) even where the change of circumstances occurred prior to 18th October 2001.

Mr. Justice Field dismissed Mr Parry’s appeal for the reasons that appear in the following short passage from his judgment:

“...when section 111A (1A) came into force the appellant came under a fresh obligation to give a “prompt” notice...The appellant came under this fresh obligation because the period during which the appellant had worked was plainly a change in circumstance affecting his entitlement to benefit for he was continuing to claim benefit which was being paid on the basis that he had never worked since signing on.”

The decision in *Parry* was interpreted in many ways and often very liberally because there was a tendency to interpret the decision as meaning even if the claim was false from outset, the defendant had come under a fresh duty from 18th October 2001 to notify promptly of their correct and true circumstances. The obvious difficulty for practitioners and judges alike was how a defendant could be indicted with failing to notify a change of circumstances when very often his circumstances had never changed.

Has the Court of Appeal finally calmed the water?

The Court of Appeal revisited *Parry in R v Mote* [2007] EWCA 3131, the well known case of the UKIP MEP on the fiddle trying to claim diplomatic immunity under European Law. Count 8 on the indictment alleged an offence of dishonestly failing to notify promptly of a change of circumstances between 18th October 2001 and 29th September 2002. The particulars of count 8 alleged a variety of failures but only one of the particulars was given a precise date as to the change (18th June 2001).

The prosecution relied upon *Parry* and asserted that the defendant came under a fresh obligation to report a change from 18th October 2001 even where the change of circumstances preceded this. The Court of Appeal rejected this:

“We have difficulty with this decision...As we understand the position...there was no statutory obligation to give notice of a

change of circumstances until section 111A (1A) came into force on 18 October 2001. Mr. Justice Field held that a fresh duty to give “prompt” notice arose when that Act came into force. We question whether this was correct, given that there was no statutory duty to give such notice before the new subsection came into effect and no relevant change of circumstances during the period that it was in effect.”

Lord Phillips CJ continued in his judgment:

“In his directions to the jury in relation to Count 8 the judge did not tell them that it was necessary for them to identify a relevant change of circumstances that the appellant failed to notify. He proceeded on the basis that the offence was committed if the appellant had failed to notify the Department that he was receiving benefits on the basis of facts that differed from the true facts. We do not consider that any offence was committed if there never was a relevant change of circumstances during the period that the appellant was receiving benefits because the initial receipt had been induced by falsely failing to declare the true facts.”

Mote is now felt to be good law and was recently approved in *Laku* in which the Crown conceded that there could not be a change of circumstances where it was alleged that the defendant always had significant bank accounts into which substantial amounts of capital were deposited well in excess of the prescribed limits.

The correct position

If a false statement, representation or document is made or furnished (after 1st July 1997) with a view to obtaining benefit an offence will be committed under section 111A (1)(a) of the 1992 Act. If benefit is being paid pursuant to a statement, representation or document that was true when made, but ceases to be true because of a change of circumstances (occurring after 18th October 2001), section 111A (1A) imposes an obligation to give prompt notice of the change, so that the recipient of benefit does not continue to receive benefit to which he is no longer entitled.

However, now that the Court of Appeal have addressed this particular issue – if an offence is committed after 15th January 2007, the Crown will find it easier to indict a defendant under the Fraud Act 2006. In addition the amendments to the Indictment Rules allowing duplicitous counts means that the Crown can charge long-running benefit fraud under the umbrella of a single count.

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James Thacker

When is property criminal property?

What does the Crown in a money laundering prosecution – or the Assets Recovery Agency, now the Serious Organised Crime Agency (“SOCA”), in civil recovery proceedings – need to prove in order to establish that property is criminal property? *R v Anwoir [2008] EWCA Crim 1354* is a recent pronouncement on this issue, and appears to give prosecutors some extra room for manoeuvre in terms of what they need to prove at trial. But it sits uneasily with other decided cases under the Proceeds of Crime Act 2002 (“POCA”). This article tries to clarify where we are now, by examining how we got here.

POCA recovery

Part 5 of POCA created a regime for the recovery of criminal property through the civil courts. Part 7 created new offences in the domain of money laundering, including offences of possessing, transferring and exporting criminal property.

While Part 5 was intended to give the courts power to award criminal property to the state, Part 7 created offences aimed at those who deal in such property. The nuisance in Part 5 is the property itself, while the nuisance in Part 7 is the people who deal in it. Therefore Parts 5 and 7 each had their own definition of criminal property. In Part 5, it was a combination of ss.241, 242 and 304. In Part 7, it was s.340. But do the two definitions amount to the same thing?

A strange anomaly has developed in the cases, and it relates to a narrow point which has great practical consequences for investigations and trials. The issue is as follows. Can the Crown in a money laundering prosecution – or the Assets Recovery Agency, now SOCA, in civil recovery proceedings – succeed by proving that the defendant could not have acquired the property lawfully? Or must the Crown / SOCA prove that the property came from one or more named species of criminality (e.g. ‘prostitution’, ‘drug trafficking’)? The civil and criminal courts have answered this question differently.

Civil recovery: the interpretation of Part 5

In *R (Director of the Assets Recovery Agency) v Green [2005] EWHC 3168 (Admin)*, Sullivan J reasoned that a claimant in civil proceedings who has to allege criminal conduct as part of his case would always have to particularise what this conduct was said to be. Moreover the language of ss.241, 242 and 304 made criminal conduct an element of the cause of action, which must therefore be alleged and proven. How else does one know if the conduct said to have occurred was an offence? Sullivan J concluded that the claimant in civil proceedings must prove on the balance of probabilities what the criminality was, and it is not sufficient merely to indicate that the defendant has no identifiable lawful income to warrant his lifestyle.

In *Director of the Assets Recovery Agency v Szepietowski [2007] EWCA Civ 766* the Court of Appeal upheld the statements of principle laid down in *Green*. Waller LJ said that a catch-all phrase such as “one or other offences involving dishonesty” is not sufficiently particular, but “mortgage fraud” will do. Moore-Bick LJ expressed the view that if the defendant is to have a fair trial, it is essential that he should know the case against him in sufficient detail to enable him to prepare to meet it. This requires the claimant to prove that specific property was obtained by or in return for a criminal offence of an identifiable kind. Examples of the level of specificity required are ‘robbery’, ‘theft’ or ‘fraud’.

Note also that paragraph 8.2 of Practice Direction to the Civil Procedure Rules Part 16 requires claimants to particularise any allegation of fraud or illegality on which they rely. Arguably the High Court in *Green* and the Court of Appeal Civil Division in *Szepietowski* were bound to come to the conclusion that they did, in view of the circumspection with which civil law regards allegations of criminality. In any event, following *Green* and *Szepietowski*, the position as regards the civil recovery provisions of POCA is settled.

Money laundering offences: The interpretation of Part 7

Meanwhile the criminal courts arrived at the opposite answer. In *R v Craig [2007] EWCA Crim 2913* Gage LJ stated

“whilst the prosecution must prove that the property is ‘criminal property’ within the meaning of the statutory definition, there is nothing in the wording of the section which imports any further requirement that the property emanated from a particular crime or a specific type of criminal conduct.”

Craig was decided in November 2007: after *Szepietowski* and *Green*. But these two cases were not considered by the court in *Craig*. Thus there was a real tension between the way criminal property was proved for the purposes of the money laundering provisions and the civil recovery provisions of POCA.



In *R v NW, SW, RC and CC [2008] EWCA Crim 2* the Court of Appeal Criminal Division dispersed this tension. Laws LJ realigned the evidential rule in money laundering offences with the civil recovery provisions. He held that for the purposes of a prosecution under section 328 of POCA the Crown, whilst it did not have to establish precisely what crime or crimes had generated the property in question, did have to establish at least the class or type of criminal conduct involved. In view of the fact that the claimant in civil proceedings is required so to do, he said that not to so require in criminal proceedings would be “anomalous, not to say bizarre”.

Summary forfeiture proceedings

An even larger anomaly is in summary forfeiture proceedings. In *Bujar Munekar v Commissioners of Customs and Excise [2005] EWHC 495 (Admin)*, the High Court was concerned with an appeal by way of case stated from a District Judge in forfeiture proceedings. These are brought under Part 5 of POCA 2002, but under a special procedure laid out in chapter 3 of Part 5. Moses LJ held:

“Insofar as it is suggested that it is incumbent upon the prosecution to identify the criminal activity, the source of the money or the criminal offence for which it is intended to use the money, that, in my judgment, is incorrect.”

This is a decision under the same Part of POCA as *Green and Szepietowski*. It was cited by the claimant in *Green*, but Sullivan J rejected the analogy, saying that “great caution should be exercised when attempting to read across” from the summary forfeiture provisions to the civil recovery provisions. The difference, he said, was that the former were concerned with cash; whereas the latter was directed at all kinds of property.

R v Anwoir

Such was the state of the authorities when the Court of Appeal came to decide *Anwoir* in June this year. It held (per Latham LJ) that there are two ways in which the Crown can prove that property derives from crime: a) by showing that it derives from conduct of a specific kind or kinds and that conduct of that kind or those kinds is unlawful, or b) by evidence of the circumstances in which the property is handled which are such as to give rise to the irresistible inference that it can only be derived from crime. This rows the law back in the Crown’s favour because it slackens the *R v NW* requirement to prove that the property derives from one or more named species of criminal conduct.

The way Latham LJ distinguishes *R v NW* is by saying that the facts of *Anwoir* fell into a class of case which (according to Latham LJ) Laws LJ himself recognised in *R v NW*: where

“the Crown might properly invite the jury to infer from the available facts that criminal activity was the only reasonable and non-fanciful explanation for the presence of the relevant property in the hands of the defendants, even though there was nothing to show what class of crime was involved.”

Furthermore, Latham LJ hints that *R v NW* was decided per incuriam because *Craig* was not brought to the court’s attention – see para 12 of *Anwoir*. (Note that this criticism could equally well be made of *Craig*, in that *Green* and *Szepietowski* were not cited to the court in that case.)

In July this year Latham LJ decided *R v F and B [2008] EWCA Crim 1868*, in which he relied upon *R v Anwoir* to allow a prosecution appeal against a terminatory ruling.

Analysis

The distinction between the two areas – Part 5 and Part 7 of POCA – may be justified on the basis that the criminal defendant has the protection of the criminal standard of proof, while the claimant in the High Court only need prove that the property was more likely than not to be recoverable property. Arguably it is a matter for defence speeches: it is open to defendants to invite the jury to conclude that they *must* have a reasonable doubt when they have heard no evidence of the type of crime from which the property derives. The jury are conversely entitled to make the inference regardless.

But the distinction is surely unsatisfactory. The common law affords subjects the fundamental right not to be called to account, nor required to justify their actions, if there is no basis for an accusation having been made in the first place. A defendant need not have to give an explanation unless the prosecution has established a case against them, capable of supporting the conclusion that they are guilty of all the elements of the offence, beyond reasonable doubt. If the prosecution can just point to the defendant’s lifestyle and simply shrug in the jury’s general direction, there is a risk of injustice.

Following *Anwoir*, the unsatisfactory distinction between criminal property in the civil courts and in the criminal courts has returned.

Off to the Lords?

Anwoir may well be decided upon by the House of Lords, which means that their Lordships will be presented with the task of squaring the criminal property circle.

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Benedict Rodgers

BAE revisited

Section 1 of the Prevention of Corruption Act 1906 makes it a criminal offence for a person to give or offer to give an agent any gift or consideration as a reward for showing favour to any person in relation to his principal's affairs. Similarly, it is an offence for the agent to accept or agree to accept any such gift or consideration. The Anti-terrorism, Crime and Security Act 2001 made it clear that the courts have jurisdiction over corruption committed abroad by nationals of the United Kingdom or a body incorporated under the law of any part of the United Kingdom for offences committed after 14th February 2002. The question of whether corruption committed abroad prior to 14th February 2002 is a criminal offence in the United Kingdom remains a moot point.

Such concerns were not, however, the reason that on the 4th December 2006 the then Attorney General, Lord Goldsmith stated,

“The Director of the Serious Fraud Office has decided to discontinue the investigation into the affairs of BAE Systems plc as far as they relate to the AlYamamah defence contract. This decision has been taken following representations that have been made both to the Attorney General and the Director of the Serious Fraud Office concerning the need to safeguard national and international security. It has been necessary to balance the need to maintain the rule of law against the wider public interest. No weight has been given to commercial interests or to the national economic interest”.

That decision was judicially reviewed and on 10th April 2008 Lord Justice Moses, in a typically hard-hitting judgement said the Serious Fraud Office's (“SFO”) decision to discontinue its corruption enquiry into arms deals with Saudi Arabia was wrong. He said that the SFO and the Government had given into “blatant threats” that Saudi co-operation in the fight against terror would end unless the probe into corruption was halted. In perhaps the most telling part of the judgment he said,

“No one, whether within this country or outside, is entitled to interfere with the course of our justice. It is the failure of government and the defendant to bear that essential principle in mind that justifies the intervention of this court.”

The press of course had a field day and no one escaped criticism.

The SFO appealed to the House of Lords and in an equally hard-hitting decision unanimously allowed the appeal. In reaching its conclusion that the SFO Director properly exercised his discretion to discontinue the investigation, the senior law lord, Lord Bingham of Cornhill, stated:

“The Director was confronted by an ugly and obviously unwelcome threat. He had to decide what, if anything, he should do.... The issue in these proceedings is not whether the decision was right or wrong, nor whether the Divisional Court or the House agrees with it, but whether it was a decision which the Director was lawfully

entitled to make.... In the opinion of the House the Director's decision was one he was lawfully entitled to make. It may be doubted whether a responsible decision-maker would, on the facts before the Director, have decided otherwise”.

Interestingly, Lord Bingham described the former Director's decision that the public interest in saving British lives outweighed the public interest in pursuing BAE to conviction as “courageous”, in marked contrast to Lord Justice Moses' view that the decision was “an outrage”.

But does the House of Lords' decision have important implications for continuing efforts to enforce anti-corruption provisions? In my view it does not. The circumstances leading to the decision to discontinue the investigation were, to say the least, unusual. The SFO continues to investigate allegations of corruption involving BAE officials, as well as several other corruption cases. On the 8th October 2008 the SFO appointed a new Head of their Anti-Corruption Unit with “wide experience in countering corruption and bribery”. If nothing else, the BAE case reaffirms that decisions by public officials remain subject to the Court's scrutiny and any decision to end corruption enquiries is challengeable.

The United Kingdom authorities have a duty to investigate allegations of corruption. The OECD Anti-Bribery Convention (“the Convention”) is aimed at reducing corruption in developing countries by requiring its signatories, under their national laws, to criminalise the bribery of foreign public officials and to impose criminal penalties on those who give, offer or promise any such bribes. Its goal is to create a truly level playing field in today's international business environment. The Convention came into effect in February 1999. The United Kingdom is a signatory to the Convention and is therefore bound by its terms. Many were of the view that the BAE investigation was discontinued to safeguard commercial interests. This would have fallen foul of Article 5 of the Convention. But Baroness Hale said

“the evidence is quite clear that this was not so”.

Following the SFO's decision to discontinue the investigation, the United States of America's Department of Justice are reported to have taken up the cudgels. We will watch with interest.

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