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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 160 – BRIBERY ACT 2010

Analysis of uncertainty around the Bribery Act 2010

Ministry of Justice Consultation on guidance about commercial organisations preventing bribery

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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 160 – Bribery Act 2010

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[1] Note that Working Group Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.

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1. INTRODUCTION

1.1 The role of the FMLC is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 This Paper, therefore, does not comment on policy issues other than as necessary to deal with issues of potential uncertainty or misunderstanding.

1.3 The Bribery Act 2010 (the "Act") introduces a new corporate offence of failure to prevent bribery. This offence is drafted in wide terms such that there is uncertainty about how firms can comply with the Act. The FMLC therefore welcomes the proposals for guidance to be published on the prevention of bribery.

1.4 However, the draft guidance published by the Ministry of Justice on 14 September 2010 (the "Guidance") does not significantly reduce the uncertainty introduced by the Act, for two reasons. First, the Guidance does not cover all aspects of uncertainty arising. Second, the Guidance is drafted in such high level terms that it does not give practical assistance to firms in understanding their obligations under the Act or the details of compliance procedures that will be considered "adequate" in any particular case.

1.5 The FMLC highlights the principal areas of uncertainty relevant to the financial markets and suggest how these could be addressed by the Guidance below.

2. UNCERTAINTIES NOT COVERED BY THE GUIDANCE

Hospitality

2.1 The Act, on its face, criminalises as a bribe any form of corporate hospitality, entertainment or promotional expenditure (together "corporate hospitality") where:

a. in the case of the section 1 offence of general bribery, there is an intention to induce a person to perform a function improperly; and

b. in the case of the section 6 offence of bribing a foreign public official, there is an intention to influence an official for the purpose of obtaining business or an advantage in the conduct of business.

2.2 In addition, corporate hospitality can trigger the offence of commercial organisations' failing to prevent bribery. This approach contrasts with other well established anti-bribery regimes (such as the US Foreign Corrupt Practices Act (the "FCPA") and Germany's anti-corruption laws) which specifically permit certain reasonable and bona fide business expenses. Businesses in the UK (and foreign businesses that fall within the ambit of the Act) are at risk of prosecution for corporate hospitality which they routinely provide to third parties (such as their clients, suppliers and business partners) and their position depends on the notoriously slippery and subjective concept of "intention". Companies are exposed to this risk in the context of failing to prevent actions undertaken—on the basis of intentions formed—by those with which they are only distantly connected (see below). It is essential therefore that the circumstances in which hospitality may be regarded as a bribery offence are clarified and bright lines established in this area.

2.3 In response to the concerns that have been raised by the legal and business communities on this subject, the following has occurred:

- The Serious Fraud Office (the "SFO") has stated that where corporate hospitality is reasonable, moderate and not lavish, there may be a technical breach of the Act but that the "public interest" would probably not require prosecution (however, the SFO has stressed that this view is subject to guidelines to be issued by the Attorney General/the Director of Public Prosecutions);

- At the Committee stage of the Act's passage through Parliament, it was noted that the question of whether corporate hospitality fell "on one side of the line or the other" was a matter of "prosecutorial discretion"; and

- The Guidance states that it is "unlikely" that hospitality which is of "small value" or which is "standard" will give rise to a section 6 offence. These guidelines go on to say that it is ultimately up to businesses and their

representative bodies to establish and disseminate "appropriate standards for hospitality and promotional expenditure".

2.4 The FMLC understands that the provision of corporate hospitality may well constitute an offence but that whether or not a prosecution will be pursued will depend on the "public interest", "prosecutorial discretion" and the "appropriate standards" that businesses set for corporate hospitality. This position has given rise to significant concerns within the business community as to the lack of legal certainty on this subject.

2.5 There is real concern that, among other things, there is no clarity as to when the "public interest" will militate against a prosecution, what is meant by "prosecutorial discretion", how and when "prosecutorial discretion" will be exercised and the level at which companies should set the bar for corporate hospitality in order to ensure they have "appropriate standards". It is also not clear whether the section on "hospitality and promotional expenditure" in the Guidance is formally part of those guidelines and can be relied on by companies, and the use of terms such as "unlikely", "small value" and "standard" creates uncertainty because there is no indication of what these mean and how they will be interpreted in practice.

2.6 In addition, the Guidance states (under Principle 4) that a company's policies should set out "… appropriate levels … of bona fide hospitality or promotional expenses to ensure that the purposes of such expenditure are ethically sound and transparent". It is not clear what is meant by "appropriate levels", "ethically sound" and "transparent" – a definitive explanation of these requirements is needed. In addition, the Guidance does not acknowledge that appropriate levels can be used in different ways (for example either institution-wide bans on the provision of gifts and hospitality above certain levels or the requirement that approval from an appropriate level of seniority within an organisation be obtained before gifts and hospitality above a certain value are provided).

2.7 Again, more specific guidance on this issue would be welcome. For example, the final Guidance could acknowledge the range of 'approval limit' mechanisms which may be available to an organisation. It could also acknowledge, as has

been confirmed by representatives of the Ministry of Justice during public consultation discussions, that it may be appropriate to impose different approval procedures or substantive 'approval limits' to different circumstances (such as dealings with public officials, which could warrant a lower approval limit or outright ban, and dealings with commercial counterparties, which could warrant higher approval limits or even general principles on the basis of which the appropriateness of gifts and hospitality may be assessed without any specific approval limits).

2.8 Alternatively, an FCPA style carve-out for corporate hospitality could be considered, or a wider statement in the final guidance that reasonable and bona fide corporate hospitality will be permitted, accompanied by a comprehensive set of examples (which reflect real-life situations in which companies provide corporate hospitality) setting out the situations in which corporate hospitality will be considered acceptable or unacceptable, as the case may be.

Meaning of associated person

2.9 Section 7 of the Act provides that "a relevant commercial organisation ("C") is guilty of an offence under this section if a person ("A") associated with C bribes another person intending (a) to obtain or retain business for C, or (b) to obtain or retain an advantage in the conduct of business for C".

2.10 Section 8 goes on to provide that A is associated with C if A performs services for or on behalf of C. The capacity in which the services are performed does not matter and accordingly A may (for example) be C's employee, agent, subsidiary or, although not expressly stated in the Act, other contractual counterparties.

2.11 There is no guidance on what degree of connection is necessary to establish the necessary association for the purpose of section 7. In the context of the financial markets, this creates significant uncertainty for investors as it is unclear what level of investment will be sufficient to make the investor company "associated" with the investee company.

2.12 The reference to subsidiary in section 8 indicates that where an investor holds a majority of the voting rights or has a right to appoint or remove a majority of the

directors, the companies will likely be associated. At the other end of the spectrum, presumably a minority investor holding one share in a public company is not associated. In between these two ends of the spectrum there is a range of investment structures. It is essential that investors are able to understand at what point they risk being liable for the offences of a company in which they have invested, regardless of the level of control they have over that company. The FMLC notes that there are existing statutory definitions of "associated" and "connected" which have an established meaning, and queries whether a similar approach could be adopted in the Act.

2.13 Although one of the principles set out in the Guidance does recognise that a company may have varying degrees of control over an associated person, the Guidance does not explain what is meant by "control", compounding the uncertainties for investors (see below).

Meaning of "relevant commercial organisation"

2.14 In section 7, "relevant commercial organisation" is given a wide meaning. It includes not only companies incorporated in the UK but also bodies corporate and partnerships formed outside the UK but which carry on a business, or part of a business, in the UK.

2.15 The Guidance does not explain or illustrate what is meant by carrying on "part of a business" in the UK. It would be useful to have some illustrations. For example, it is unclear whether the following business models fall within the scope of the Act:

a. a non-UK incorporated company that is listed in the UK but carries on no other business in the UK;

b. a non-UK incorporated company that has a UK-incorporated subsidiary;

c. a non-UK incorporated company that distributes/sells its products in the UK; and/or

d. a non-UK incorporated company that sources materials for its products in the UK.

3. COMMENTS ON THE GUIDANCE

Control

3.1 As explained above, the lack of guidance on the meaning of "associated" means that investors are unclear about when they are exposed to liability for bribery taking place in investee organisations and fear that they are at risk in relation to companies with which they have only the remotest connection. Only one principle (principle 4) set out in the Guidance is qualified by reference to a company's ability to control associated persons. While this qualification is helpful, it would be of more practical use if there was an indication of the level of control envisaged.

3.2 The level of control an investor has is very different to a corporate that, say, has a subsidiary in Mexico where that subsidiary is on its balance sheet and therefore part of the Group and where financial reporting will be consolidated.

3.3 Some of the typical more illiquid investment structures that an investor may use include:

a. a minority shareholding with/without veto rights;

b. a minority shareholding with board rights and with/without veto rights;

c. the largest shareholder (not necessarily the majority);

d. a majority shareholding with/without board majority rights;

e. a debt/equity restructuring leading to majority shareholding or becoming the single largest shareholder; and/or

f. a covenant-heavy private loan agreement.

3.4 In each investment structure above, the investor will have a different degree of control over the investee company. Typically, the Investor is a source of capital and is not providing day to day management of the business: this will be the responsibility of the investee company's executive management. If it is the intention of the legislation that the investor should take responsibility for human

resources selection and monitoring, this would entail a very significant alteration in the investment approach adopted in most cases hitherto and may not be possible in many cases.

3.5 At present, investors in all of the above structures will be uncertain as to their obligations under the Act in respect of an investee company. If the Guidance gave some indication of the different processes that might be expected from, for example, a minority shareholder with no veto rights to a majority shareholder, that would allow investors to calibrate the requirements of the Act.

3.6 There is also a temporal uncertainty: although an investor may have a certain level of control on entering into the investment, this is likely to vary during the life of investment, further funding rounds and on exit from the investment. It is unclear whether an investor's liability for the investee' company's acts is determined by reference to its level of control at the time that the bribery takes place; or at some earlier time when bribery could theoretically have been prevented.

Management involvement

3.7 Principle 2 refers to top level management establishing an anti-corruption culture and taking steps to ensure that this is "communicated" across an organisation. However, the Guidance (and particularly the illustrative scenarios) goes further and implies that top level management must be involved in the detail of the implementation and operation of an organisation's anti-corruption or compliance procedures on a day to day basis.

3.8 For example: in illustrative scenario 1 (intermediaries and agents), the Guidance asks whether top level management considered the arrangements relating to the specific appointment of an organisation as an intermediary; in illustrative scenario 2 (business partners) the Guidance assumes that top level management would have been involved in negotiating an organisation's involvement in a particular joint venture and also criticises the delegation of certain compliance functions by management.

3.9 This may be partly due to the fact that the illustrative scenarios focus on "medium size" domestic enterprises. Illustrative scenario 5 (political and charitable

donations) appears to be aimed at larger organisations and refers to top level management taking steps "…at the centre…" to ensure that local managers were aware of relevant anti-bribery policies. The Guidance also acknowledges that fostering such a culture can include the delegation of certain day to day functions to a senior compliance manager.

3.10 In large multi-national organisations, it may not be practical for top level management to be involved in compliance processes and procedures on a day to day basis as is suggested in some of the illustrative scenarios. They can be and are, however, involved in internal and external communications clarifying an organisation's 'culture' and commitment to combat bribery. Mechanisms can be and are put in place to ensure they are involved in more detail when necessary such as regular and ad hoc reporting lines. Finally, such organisations have sufficient resources to employ separate senior and experienced staff in their legal and compliance function to oversee the development and implementation of anti-bribery policies.

3.11 Further clarification as to the extent to which top level management is expected to be involved in the detail of compliance issues in relation to any transaction or other business venture in any particular case would be welcome. In particular, Principle 6 (monitoring and review) acknowledges that in large organisations the ongoing monitoring and review of an organisation's policies may be reported regularly to the Audit Committee or Board of Directors. The use of such reporting lines in complying with Principle 2 could also be referred to in the discussion of that principle.

Due diligence

3.12 Principle 3 refers to due diligence policies which cover "…all parties to a business relationship, including the organisation's supply chain…". On the face of it this wording could set an expectation that due diligence must be conducted on all parties that a relevant commercial organisation has a business relationship with, even those over whom that organisation has little or no direct or indirect control. This is regardless of whether or not they are performing services for or on behalf of the relevant commercial organisation. This reflects the uncertainty as to the

scope of the definition of an "associated person" for the purposes of the corporate offence under section 7.

3.13 The Guidance refers only to jurisdiction, transaction and counterparty risk at a general level as factors relevant to determining the extent of any appropriate due diligence. More specific guidance on this issue would be welcome. In particular, any further guidance as to the scope of the definition of "associated person" and the nature and extent of control which may be relevant to such assessment should also be reflected in the guidance relating to Principle 3.

4. CONCLUSION

The above uncertainties are of concern not only to corporates and investors in them, but also to professionals subject to the Proceeds of Crime Act 2002, who are subject to various anti-money laundering obligations relating to the "proceeds of crime". To the extent that the Act's application is uncertain, professionals' anti-money laundering obligations will also be uncertain.

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