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CORPORATE CRIME BRIEFING

SERIOUS FRAUD OFFICE PUBLISHES FOURTH DEFERRED PROSECUTION AGREEMENT

28 JANUARY 2019
London

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On 10 April 2017, the Rt. Hon. Sir Brian Leveson PC approved the UK's fourth Deferred Prosecution Agreement ("**DPA**"), resulting in Tesco Stores Limited ("**TSL**") agreeing to pay a financial penalty of £128,992,500 and £3,069,951 of investigation costs. The DPA had been embargoed from publication, pending the trial of three former Tesco executives on related charges of fraud and false accounting. Following each individual being acquitted of all charges, the DPA was published on 23 January 2018.

Background

By way of background, and as set out in our previous briefing in relation to the second DPA here, DPAs provide a means, in appropriate cases, of resolving offending by corporate entities for fraud, bribery and other economic crime. Under a DPA, a company agrees to certain conditions which are likely to include a financial penalty, compensation to victims, disgorgement of profits, payment of any reasonable costs of the prosecutor in relation to the alleged offence or the DPA itself, cooperation in any investigation related to the alleged offence, and measures to prevent future offending. The company and the SFO will also agree a public statement of facts setting out the company's wrongdoing. In return, and provided the conditions of the DPA are met, the company will not face prosecution. DPAs are public, and must be applied for and approved by a court before coming into effect. A court will approve a DPA which it considers to be in the interests of justice, and which has fair, reasonable and proportionate terms.

SFO v Tesco Stores Limited

On 10 April 2017, the Rt. Hon. Sir Brian Leveson PC (who also heard the applications in respect of the other three UK DPAs) approved a DPA between TSL and the SFO, the UK's fourth DPA. The DPA concerned allegations that TSL had committed the offence of false accounting under s.17 of the Theft Act 1968 by, between 1 February 2014 and 23 September 2014, allegedly falsifying the digital accounting records of TSL and Tesco Plc and draft statutory interim accounts for Tesco Plc by relying on commercial income figures which gave a false account of the commercial income earned by TSL and a false account of the financial position of Tesco Plc and TSL with a view to making a gain for itself or another, or causing loss to another.

Prior to the DPA being approved the SFO had, on 9 September 2016, charged three former Tesco executives with offences of fraud and false accounting in relation to these accounting records. The individuals were Carl Rogberg (former UK Financial Director), Chris Bush (former UK Managing Director) and John Scouler (former UK Food Commercial Director) (together the "**Three Former Employees**").

The DPA was finalised before the Three Former Employees were tried and was based on TSL and SFO having agreed, among other things, that:

(a) the Three Former Employees were aware of and dishonestly perpetuated a misstatement leading up to a Tesco Plc trading update issued on 29 August 2014;

(b) the trading update overstated the profits for the Tesco group for the 6 months to 23 August 2014 by £257m; and

(c) the Three Former Employees had therefore falsified or concurred in the falsification of accounts or records made for an accounting purpose.

The DPA judgment was handed down on 10 April 2017 but was embargoed pending the conclusion of the prosecution of the Three Former Employees, due to the risk of the details of the DPA undermining or prejudicing those proceedings.

The first trial of the Three Former Employees was abandoned due to Carl Rogberg suffering a heart attack. Chris Bush and John Scouler were re-tried and, on 6 December 2018, they were acquitted of all charges after the trial judge ruled that they had no case to answer. Separately, Carl Rogberg, who had been severed from the re-trial, was acquitted of all charges on 23 January 2019 after the SFO offered no evidence. Following the acquittals, the embargo on the DPA was lifted on 23 January 2019.

Terms of the DPA

The terms of the DPA (which will remain in place until 10 April 2020) require TSL to, among other things:

- cooperate with the SFO and, at the SFO's reasonable request, other law enforcement and regulatory agencies in all matters relating to the relevant conduct;
- pay a financial penalty of £128,992,500;
- pay costs of £3,069,951; and
- complete, at its own expense, a five-year compliance related project (which started in 2015).

Public interest

A court will approve a DPA only if it finds that the DPA is in the public interest. The DPA Code of Practice (the "**DPA Code**") sets out a list of factors to be considered in this context.

Seriousness of the conduct

The more serious the offence, the more likely it is that the public interest will demand a prosecution and the less likely it is that a DPA will be in the interests of justice. A discussion of how seriousness was assessed in the first three DPAs can be found in our previous briefing in relation to the third DPA here.

Sir Brian Leveson PC identified the following five factors which were considered to have aggravated the seriousness of the matter:

- substantial harm was caused to the integrity of the market and the confidence in the way in which it operates;
- there was organised and planned misconduct, involving other employees through the application of pressure;

- although the proposed count on the indictment was limited to one set of results, it was alleged that the accounts had been overstated over a number of years;
- the culture of TSL placed its accounting and financing functions under pressure to help deliver to budget, including through illegitimate methods; and
- TSL senior managers were allegedly aware of the unlawful activity but failed to raise the issue.

Cooperation

Sir Brian Leveson PC noted that the DPA Code provides that "*co-operation is the first, and a potentially potent public interest factor against prosecution*" and, as with the first and second DPAs, he placed considerable weight on the company having "self-reported". He praised the immediate response after the issue had been raised by a whistle-blower, which included appointing internal and external auditors, suspending senior employees thought to have been involved, holding urgent board meetings and committing to full-cooperation with the SFO.

TSL was said to have provided the "*very fullest cooperation*", with examples of its *"proactive assistance"* to the SFO including:

- refraining from interviewing witnesses or taking statements during the investigation even though TSL and Tesco Plc were also dealing with civil claims;
- TSL and Tesco Plc agreeing to a limited waiver of privilege for documents pre-dating the profit statement;
- voluntarily disclosing material information to the investigation;
- assisting the SFO with setting up interviews;
- organising over 1,600 evidence bags with hard copy materials; and
- providing the SFO with mailbox accounts of former and current employees without first filtering out privileged documents, having agreed that any issues could be resolved by independent counsel.

Other factors

Sir Brian Leveson PC, referencing his Rolls Royce DPA judgment, stated that it is "*of real significance*" whether or not those who were implicated in or should have been aware of illegal behaviour, or of a culture which permitted illegality to thrive, remain members of the senior management. He was satisfied that both the senior management and those responsible for the strategic direction of TSL and its parent, Tesco Plc, were different to those responsible for the operation of the business at the time of the relevant events. He also stated that a complete change at the top is not a prerequisite for approval of a DPA but went on to say that it was likely to be difficult to demonstrate *"… the critical corporate recognition of the need for change if anyone in a senior management position who is specifically implicated in criminal behaviour remains in position."*

TSL's remedial measures were found to be *"wide-ranging and comprehensive"* and the company had simplified reporting lines to ensure clearer accountability, relaunched an external whistle-blower service, increased personnel (in Finance, Legal, Compliance and Group Internal Audit Teams), introduced a new commercial buying model to reduce the possibility of overstating profits and, finally, invested in technology to support a new financial control framework.

Sir Brian Leveson PC stated that, while the national economic interest is irrelevant to the question of whether a DPA is in the interests of justice and a large company should not be immune from prosecution, it was a relevant factor that a criminal conviction could have a real impact on persons who have no connection to the relevant events, including its employees, pensioners and those in its supply chain.

While of less importance than the other factors, another factor in favour of a DPA in this matter was that it allowed for the efficient use of public resources and one aspect of this was encouraging and incentivising the self-reporting of wrongdoing by corporate entities in similar situations.

Conclusion

Sir Brian Leveson PC said that he was entirely satisfied that the balance in this case came down firmly on the side of a DPA being in the overall interests of justice.

Calculation of financial penalty

As set out in the Code of Practice, any financial penalty imposed by a DPA is to be broadly comparable to a fine that the court would have imposed upon a company pleading guilty. This enables the courts to have regard to relevant pre-existing sentencing principles and guidelines in determining the appropriate level for a financial penalty. The total amount to be paid to the SFO includes not only a financial penalty, but also disgorgement of any profits following from the conduct in question and the SFO's legal costs.

Disgorgement and Compensation

The Sentencing Guideline for Corporate Offenders: Fraud, Bribery and Money Laundering (the "**Guideline**") requires the removal of all gain, as well as appropriate punishment. However, as it was not possible to identify any profit derived by Tesco Plc or TSL in this matter, the question did not arise.

Nor was any compensation ordered, as the SFO said that this would not be a straightforward position, the SFO had not been approached by any investor seeking compensation and the FCA had, separately, concluded that the publication of the statement had constituted market abuse contrary to s.118(7) of the Financial Services and Markets Act 2000 and had, as a result, agreed with Tesco Plc and TSL that they would pay an estimated £84.4m under a statutory compensation scheme.

Financial penalty

The usual starting point in calculating a financial penalty is to establish the consequential "harm" from the offending. The Guideline does not make a specific provision for determining a harm figure for the offence of false accounting by a corporate offender and, in this case, there was no specific gain made or loss caused.

In such circumstances, the Guideline provides that "*10-20% of the relevant revenue (for instance between 10-20% of the worldwide revenue derived from the product or business area to which the offence relates for the period of the offending) may be an appropriate measure*". Sir Brian Leveson PC was content to follow the SFO's suggested approach of having regard to the reported UK Food Commercial income of TSL, which amounted to £1.021 billion. From this, the overstatement of around £257m was deducted, giving a 'true' figure of £764.4m. The starting point for determining the percentage of 15% was reduced to 11.25% to reflect the fact that the harm caused from misleading the market lasted for three weeks only. Therefore, the overall harm figure was £85.955m. Sir Brian Leveson PC used as a cross-check the quantum of compensation that the FCA subsequently estimated would be payable under its compensation scheme; he considered that these losses could reasonably be taken as an alternative harm figure.

Having assessed the harm figure, the Guideline requires that the financial penalty should be multiplied by a multiplier based on culpability. To determine whether the conduct falls into high, medium or low categories of culpability, the Guideline sets out a non-exhaustive hierarchy of culpability characteristics. Each category contains a range of percentage multipliers. The Guideline provides a non-exhaustive list of aggravating and mitigating factors which adjust the multiplier within the range for the three categories.

In this case the culpability multiplier was assessed at 300%. Sir Brian Leveson PC stated that this was a case of high culpability because, over a sustained period of time, senior management allegedly played a leading role in organising, planning and pursuing the deliberate misstatement of commercial income, applying pressure on employees to do so. The factors referred to above as being relevant to the "seriousness" of the offence were also relevant factors when determining the culpability.

Sir Brian Leveson PC noted that the four factors tended towards lower culpability, albeit they were not enough to reduce the culpability down from "high":

- TSL having no previous relevant convictions and not having been subject to civil or regulatory enforcement action;
- TSL having voluntarily reported the offending and co-operating with investigations;
- TSL taking steps to deal with the cultural problem and what happened occurred as a consequence of the decisions of leaders who are no longer in place; and
- TSL not having gained or profited from what happened.

Discount

Sir Brian Leveson PC, following the same approach as in the Rolls Royce DPA, found that the financial penalty on TSL should be discounted by 50% to reflect its *"exemplary standard of co-operation",* thus reducing the penalty to £128,992,500.

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